

## COMMENTS

### THE SEC'S POTENTIAL APPOINTMENTS CLAUSE DEFECT AND HOW IT COULD IMPACT THE ADMINISTRATIVE STATE

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#### INTRODUCTION

Twice since the turn of the twenty-first century, the United States corporate and financial sectors have been embroiled in scandals, which have been covered heavily in the national news media.<sup>1</sup> The persistent negative publicity led to widespread public outrage and swift congressional response in the form of increased regulation and oversight. Following the corporate accounting scandals in 2001, Congress passed the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), which created the Public Company Accounting Oversight Board (“PCAOB”).<sup>2</sup> In 2010, the Supreme Court held that the PCAOB’s two layers of for-cause removal violated the separation of powers and the vesting of executive power in the President by insulating the Board

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1 The first scandal occurred after Enron’s collapse in 2001 and other accounting scandals, when criticism rained down on these companies and, “[a]s the audit failures piled up on one another, investors lost confidence in managers, market intermediaries and auditors alike.” William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023, 1023 (2003); see also Gretchen Morgenson, *Worries of More Enrons to Come Give Stock Prices a Pounding*, N.Y. TIMES, Jan. 30, 2002, at C1 (reporting on the Enron scandal’s effects on the economy). The second scandal occurred after the 2007 financial crisis, when millions of homes were foreclosed on and governments and banks worldwide spent more than \$17 trillion assisting financial institutions. Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951, 957 (2011) (detailing the severe and far-reaching nature of the financial crisis); Laura Kusisto, *Many Who Lost Homes to Foreclosure in Last Decade Won’t Return—NAR*, WALL ST. J. (Apr. 20, 2015, 12:50 PM), <http://www.wsj.com/articles/many-who-lost-homes-to-foreclosure-in-last-decade-wont-return-nar-1429548640>.

2 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101(a), 116 Stat. 745 (2002) (codified in scattered sections of 15, 18, 28, and 29 U.S.C.) (establishing PCAOB, “in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors”).

from presidential oversight or control.<sup>3</sup> Following the 2007 global financial crisis, Congress responded with the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank” or “Dodd-Frank Act”),<sup>4</sup> which increased the scope of the Securities and Exchange Commission’s (“SEC”) regulatory and enforcement capabilities.<sup>5</sup> Prior to the Dodd-Frank Act, the SEC could require only registered brokers and investment advisers to pay fines in in-house proceedings presided over by Administrative Law Judges (“ALJs”),<sup>6</sup> whereas it only could bring insider trading, securities fraud, or accounting fraud actions against unregistered individuals in federal court.<sup>7</sup> Indeed, in 2013, the SEC filed 755 actions in the prior year—the most in its history for a given year—ranging from “market structure to financial reporting, asset management to insider trading, municipal securities, FCPA, and more,” which netted the SEC \$16 million in penalties.<sup>8</sup> Dodd-Frank empowered the SEC to decide where to bring enforcement proceedings.<sup>9</sup>

In the years following congressional action and the eventual decrease in public and congressional outrage,<sup>10</sup> however, the affected industries have

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<sup>3</sup> See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 496 (2010) (holding that because the President was unable “to oversee the Board, or to attribute the Board’s failings to those whom he [could] oversee, [he was] no longer the judge of the Board’s conduct,” which “is contrary to Article II’s vesting of the executive power in the President”). However, this victory was more symbolic than substantive, since the Court merely severed the statute’s for-cause removal provision, leaving intact the Board’s broad powers. *Id.* at 508; Jerome Nelson, *Administrative Law Judges’ Removal “Only For Cause”: Is That Administrative Procedure Act Protection Now Unconstitutional?*, 63 ADMIN. L. REV. 401, 408 (2011) (“Despite language which may have pleased the plaintiffs philosophically, the decision had no impact on the Board’s investigation of the accounting firm, nor did it alter the PCAOB’s rules, policies, or procedures.”).

<sup>4</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> See *infra* Part I.A.

<sup>6</sup> See 17 C.F.R. § 200.14(a) (1995) (delineating the responsibilities that SEC ALJs have).

<sup>7</sup> Peter J. Henning, *The S.E.C.’s Use of the ‘Rocket Docket’ Is Challenged*, N.Y. TIMES: DEALBOOK (Aug. 25, 2014, 11:48 AM), [http://dealbook.nytimes.com/2014/08/25/the-s-e-c-s-use-of-the-rocket-docket-is-challenged/?\\_r=0](http://dealbook.nytimes.com/2014/08/25/the-s-e-c-s-use-of-the-rocket-docket-is-challenged/?_r=0); see also Andrew Ceresney, Dir., Securities and Exchange Comm’n Div. Enft, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014), <https://www.sec.gov/News/Speech/Detail/Speech/1370543515297> (explaining how penalties against entities not regulated by the SEC were only available in the district court before the Dodd-Frank Act was enacted).

<sup>8</sup> Ceresney, *supra* note 7.

<sup>9</sup> See Josh Beckerman, *SEC Proposes Changes to Administrative Proceedings*, WALL ST. J. (Sept. 24, 2015, 6:25 PM), <http://www.wsj.com/articles/sec-proposes-changes-to-administrative-proceedings-1443133524> (noting that partly due to the enhanced powers accorded to the SEC under Dodd-Frank, “[t]he agency has increasingly steered cases to hearings in front of its appointed administrative judges rather than taking them to federal court”).

<sup>10</sup> See Floyd Norris, *Financial Crisis, Over and Already Forgotten*, N.Y. TIMES (May 22, 2014), [http://www.nytimes.com/2014/05/23/business/the-financial-crisis-already-forgotten.html?\\_r=0](http://www.nytimes.com/2014/05/23/business/the-financial-crisis-already-forgotten.html?_r=0) (describing a House Financial Services Committee hearing in which some congressmen questioned the need for the Financial Stability Oversight Council,

sought to invalidate the recently enacted changes by suing in federal court.<sup>11</sup> In September 2015, the SEC responded to Due Process challenges to its ALJ proceedings by proposing new rules that provide for more thorough hearings, which it claimed would “modernize our rules of practice for administrative proceedings, including provisions for additional time and prescribed discovery for the parties.”<sup>12</sup> On July 29, 2016, the SEC adopted the amendments “substantially as proposed.”<sup>13</sup> The SEC’s use of ALJs for enforcement actions previously brought in federal courts has been a particular source of strife.

The purpose of this Comment is to examine whether the SEC’s ALJ appointments violate Article II’s Appointments Clause. If ALJs are inferior officers, as has been argued, then the President, a court of law, or a department head must appoint them.<sup>14</sup> Unlike other legal works to date, this Comment analyzes the effects of an Appointments Clause violation on both the SEC and the administrative state as a whole. Even if the Supreme Court were to rule that no constitutional infirmity exists, the Comment argues that the challenges would have been successful at least in part because the SEC and Congress have already responded to the negative publicity stemming from the Due Process and Appointments Clause claims.

Part I briefly explains how the recent financial crises have contributed to the contentious climate with respect to the SEC and provides background information on the SEC’s enforcement scheme and statutory structure, as well as the appointment process of SEC ALJs and the powers ALJs possess. Part II discusses the merits of the more recent structural constitutional challenges. First, it considers whether federal jurisdiction exists prior to the completion of an administrative proceeding. Assuming jurisdiction exists, it discusses whether the Appointments Clause and the two layers of for-cause removal challenges are likely to succeed. Both challenges depend on whether ALJs are inferior officers. Historically, the Supreme Court has not established clear criteria for what constitutes an inferior officer.<sup>15</sup> The Court

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which had been established under Dodd-Frank to ensure that financial institutions would have enough capital to avoid future financial crises).

11 See *infra* Part II (discussing the challenges that litigants have posed to the SEC’s ability to bring administrative enforcement actions under Dodd-Frank).

12 Press Release, SEC, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015), <http://www.sec.gov/news/pressrelease/2015-209.html>.

13 Amendments to the Commission’s Rules of Practice, 81 Fed. Reg. 50212-01, 50214 (July 29, 2016) (codified at 71 C.F.R. pt. 201 (2016)).

14 U.S. CONST. art. II, § 2, cl. 2 (“[T]he Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.”).

15 See *Morrison v. Olson*, 487 U.S. 654, 671 (1988) (“In the practical course of the government there does not seem to have been any exact line drawn, who are and who are

may be wary of upending the administrative state by holding that ALJs are inferior officers.

Part III considers the potential repercussions for the SEC if the Supreme Court were to rule that ALJs are inferior officers. It examines how other agencies that were recently found to have had defective appointments—the National Labor Relations Board (“NLRB”) and the Consumer Financial Protection Bureau (“CFPB”)—dealt with these challenges and how it affected prior decisions. It also considers the effects a finding that ALJs are inferior officers would have on the Social Security Administration—the agency that relies most heavily on ALJs—as well as on other agencies.<sup>16</sup>

Part IV argues that even if the Court does not eventually rule that ALJs are inferior officers, the current litigation already has and likely will continue to change SEC practices. The Due Process and Equal Protection claims against the SEC are expected to fail.<sup>17</sup> In spite of their weaknesses as legal claims, however, they have been highly influential in pressuring the SEC to modernize its in-house proceedings. Likewise, even if the Appointments Clause claim fails, it is likely to transform SEC decisions about whether to bring enforcement actions in federal courts or before ALJs. Indeed, the SEC has already responded to the challenges against its use of ALJs.<sup>18</sup>

In the conclusion, I argue that both the Due Process and Appointments Clause arguments have contributed to bringing about the substantive changes sought by the SEC’s challengers, and that neither argument, by itself, would have been sufficient. Although the Due Process claims are unlikely to prevail in court, they have inspired significant public condemnation of the SEC’s in-house proceedings,<sup>19</sup> leading the SEC to ratify

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not to be deemed *inferior* officers, in the sense of the constitution, whose appointment does not necessarily require the concurrence of the senate.”) (internal citation omitted).

16 See Jeffrey S. Lubbers, *Should Congress Create a Special Category of SSA ALJs?*, 38 ADMIN. & REG. L. NEWS 5, 5 (Winter 2013) (noting that the SSA employs 1400 ALJs, a figure that accounts for approximately 85% of all ALJs).

17 See *infra* Part IV.A

18 See *infra* Part IV.B.

19 E.g., Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015 10:30 PM), <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803>; Jean Eaglesham, *SEC Gives Ground on Judges*, WALL ST. J. (Sept. 24, 2015, 8:30 PM), <http://www.wsj.com/articles/sec-gives-ground-on-judges-1443139425>; Henning, *supra* note 7; Nate Raymond, *U.S. Judge Criticizes SEC Use of In-House Court for Fraud Cases*, REUTERS (Nov 5, 2014, 1:45 PM), <http://www.reuters.com/article/2014/11/05/us-sec-fraud-rakoff-idUSKBN0IP2EG20141105#6qxy9Y4k8dl23RSB.97>; Russell G. Ryan, *The SEC as Prosecutor and Judge*, WALL ST. J. (Aug 4, 2014, 7:36 PM), <http://www.wsj.com/articles/russell-g-ryan-the-sec-as-prosecutor-and-judge-1407195362>; Bob Van Voris & Matt Robinson, *For the SEC’s In-House Court, a Question of Justice for All*, BLOOMBERG (Aug. 10, 2015, 5:05 AM), <http://www.bloomberg.com/news/articles/2015-08-10/for-the-sec-s-in-house-court-a-question-of-justice-for-all>; Daniel Fisher & Daniel R.

new rules to provide for greater process,<sup>20</sup> and moving Congress to propose legislation giving those subject to SEC civil actions the option of having the proceeding take place before an ALJ or a federal judge.<sup>21</sup> What impact the Appointments Clause challenges have on ALJs in other agencies will hinge on whether and on what grounds the Court were to find an Appointments Clause defect, the retroactive effect of such a ruling, and the willingness of litigants in other agency proceedings to raise Appointments Clause issues.

## I. ADMINISTRATIVE LAW JUDGES AND THE SEC'S ENFORCEMENT AND ADJUDICATORY SCHEME

To best understand the motivation behind the recent string of challenges and the current salience of the issue, it is important to consider the tension between Wall Street and Congress (mostly its Democrats<sup>22</sup>) and Congress's periods of consternation following these crises. This is helpful in understanding the impetus behind the challenges discussed below.

### A. Recent Expansion of the SEC's Enforcement Capabilities

Public outrage following the 2008 financial crisis<sup>23</sup> and the widespread belief that there was not enough government regulation over Wall Street<sup>24</sup> led the Democratic-controlled Congress to increase the enforcement power of the SEC to better regulate and punish the financial sector.<sup>25</sup>

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Walfish, *The Real Problem with SEC Administrative Proceedings, and How to Fix It*, FORBES (July 20, 2015, 7:55 AM), <http://www.forbes.com/sites/danielfisher/2015/07/20/the-real-problem-with-sec-administrative-proceedings-and-how-to-fix-it>.

<sup>20</sup> See Press Release, SEC, *supra* note 12.

<sup>21</sup> Due Process Restoration Act of 2015, H.R. 3798, 114th Cong. § 2(a) (2015).

<sup>22</sup> Binyamin Appelbaum & David M. Herszenhorn, *Financial Overhaul Signals Shift on Deregulation*, N.Y. TIMES (July 15, 2010), <http://www.nytimes.com/2010/07/16/business/16regulate.html> (reporting on the passage of a bill aimed at expanding federal financial regulation, which had been heavily promoted by congressional Democrats).

<sup>23</sup> See Michael Erman, *Five Years After Lehman, Americans Still Angry at Wall Street: Reuters/Ipsos Poll*, REUTERS (Sept. 15, 2013, 7:05 AM), <http://www.reuters.com/article/us-wallstreet-crisis-idUSBRE98E06Q20130915> ("As many as 44 percent of those polled believe the government should not have bailed out financial institutions . . . . Fifty-three percent think not enough was done to prosecute bankers . . . .").

<sup>24</sup> See Catherine Rampell, *Lax Oversight Caused Crisis, Bernanke Says*, N.Y. TIMES, Jan. 4, 2010, at A1 (reporting that according to former Federal Reserve Chairman, Ben Bernanke, regulatory failure was the primary cause of the housing bubble and subsequent financial crisis).

<sup>25</sup> Indeed, the SEC reported that for fiscal year 2015, its ALJs issued "207 initial decisions, held twenty-seven hearings, and ordered civil penalties totaling \$20,823,750 and disgorgement totaling \$12,065,036." SEC, *Office of Administrative Law Judges*, <http://www.sec.gov/alj> (last visited Sept. 15, 2016).

As a result, Congress passed the Dodd-Frank Act—mostly along party lines<sup>26</sup>—“[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”<sup>27</sup> Dodd-Frank gave the SEC the authority to impose monetary fines against individuals<sup>28</sup> and to choose whether to bring enforcement actions in federal court or within the agency, where it may either appoint an ALJ or have the action decided by the Commission itself.<sup>29</sup> Prior to Dodd-Frank, the SEC’s in-house enforcement had been limited to cease-and-desist orders against further illegal activity and to equitable relief in the form of disgorgement against regulated individuals or entities.<sup>30</sup>

### *B. Background on the ALJ Hiring and Hearing Process*

The Administrative Procedure Act (“APA”) permits agencies to appoint ALJs to preside over hearings.<sup>31</sup> Agencies long have relied on hearing officers—previously referred to as examiners.<sup>32</sup> The SEC has defended its use of ALJs—an authority, it argues, that Congress has provided to it in both the APA and Dodd-Frank. The SEC notes that it has used ALJs “throughout the 42-year history of the Division of Enforcement” and that these “ALJs have been presiding over and adjudicating complex securities cases for decades.”<sup>33</sup>

<sup>26</sup> See Wall Street Reform and Consumer Protection Act of 2009: House Roll Vote No. 968 (Dec. 11, 2009) p. H.R. 4173, <http://clerk.house.gov/evs/2009/roll968.xml> (reporting that the overwhelming majority of congressional Democrats voted in favor of Dodd-Frank, while zero Republicans did so); Wall Street Reform and Consumer Protection Act of 2009: Senate Roll Vote No. 162 (May 20, 2010) p. H.R. 4173, [http://www.senate.gov/legislative/LIS/roll\\_call\\_lists/roll\\_call\\_vote\\_cfm.cfm?congress=111&session=2&vote=00208](http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=2&vote=00208) (reporting that the vast majority of U.S. senators who voted in favor of the bill’s passage were Democrats).

<sup>27</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, pmb., 124 Stat. 1376 (2010).

<sup>28</sup> 15 U.S.C. § 77h-1(g) (2010) (permitting the SEC to impose civil penalties of varying amounts on violators of Dodd-Frank).

<sup>29</sup> 15 U.S.C. §§ 77t-u.

<sup>30</sup> Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 392–96 (2008).

<sup>31</sup> See generally 5 U.S.C. §§ 556(a), 557(b) (2012) (authorizing at least one ALJ to preside at the evidence-collecting stage of the hearing, and, under certain circumstances, to decide the case altogether); *id.* § 3105 (requiring that agencies “appoint as many administrative law judges as are necessary”).

<sup>32</sup> See VANESSA K. BURROWS, CONG. RESEARCH SERV., RL34607, ADMINISTRATIVE LAW JUDGES: AN OVERVIEW 1 n.2 (2010), <http://ssaconnect.com/tfiles/ALJ-Overview.pdf> (“In 1978, Congress changed the title ‘hearing examiners’ to ‘Administrative Law Judges.’”).

<sup>33</sup> Ceresney, *supra* note 7.

### 1. The ALJ Hiring Process

Congress permits the SEC to hold hearings before either the Commission or a designated officer, i.e. an ALJ.<sup>34</sup> The Office of Personnel Management (“OPM”) oversees the pool of potential ALJ candidates and creates the standards and qualifications needed to become an ALJ.<sup>35</sup> When an agency wishes to hire an ALJ, OPM provides it with three ALJs to choose from,<sup>36</sup> and ranks them “according to their qualifications and skills.”<sup>37</sup> An agency may borrow ALJs from another agency, a process that OPM oversees.<sup>38</sup> ALJs are qualified and experienced attorneys.<sup>39</sup> Of importance for this Comment, the SEC conceded that the Commissioners do not appoint its ALJs, but rather the SEC’s Chief ALJ does.<sup>40</sup>

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<sup>34</sup> 15 U.S.C. § 77u (2012) (“All hearings shall be public and may be held before the Commission or an officer or officers of the Commission designated by it . . .”).

<sup>35</sup> See 5 U.S.C. § 1302(a) (2012) (authorizing OPM to “prescribe regulations for, control, supervise, and preserve the records of, examinations for the competitive service”). For an in-depth description of the ALJ hiring process, see BURROWS, *supra* note 32, at 2–6.

<sup>36</sup> See 5 C.F.R. § 930.204 (1995) (“An agency may appoint an individual to an administrative law judge position only with prior approval of OPM, except when it makes its selection from the list of eligibles provided by OPM.”); BURROWS, *supra* note 32, at 2.

<sup>37</sup> BURROWS, *supra* note 32, at 2.

<sup>38</sup> See 5 U.S.C. § 3344 (2012) (“An agency . . . which occasionally or temporarily is insufficiently staffed with administrative law judges . . . may use administrative law judges selected by the Office of Personnel Management from and with the consent of other agencies.”); 5 C.F.R. § 930.208 (1995) (noting that, in accordance with § 3344, “OPM administers an Administrative Law Judge Loan Program that coordinates the loan/detail of an administrative law judge from one agency to another”).

<sup>39</sup> See BURROWS, *supra* note 32, at 2–3 (enumerating the qualifications required to become an ALJ); see also *NLRB v. Permanent Label Corp.*, 657 F.2d 512, 527 (3d Cir. 1981) (en banc) (Aldisert, J., concurring) (“[T]he selection process for ALJs should inspire more respect for this office than is generally extended by Article III judges; it is a process that requires rigorous inquiries into the background and competence of the candidates.”); *Duka v. SEC*, 103 F. Supp. 3d 382, 387 n.6 (S.D.N.Y. 2015) (commenting that the ALJ at issue “ha[d] a distinguished biography”); James P. Timony, *Disciplinary Proceedings Against Federal Administrative Law Judges*, 6 W. NEW ENG. L. REV. 807, 811–14 & 814 n.43 (1984) (discussing that in light of the discretion that ALJs possess and the process by which they are selected, among other features of their positions, they yield power similar to that of Article III judges).

<sup>40</sup> 17 C.F.R. § 200.30-10(a)(2) (1995) (granting the Chief ALJ the authority to “designate administrative law judges pursuant to Rule 110 of the Commission’s Rules of Practice”); see also *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 283 (D.C. Cir. 2016) (noting that the SEC had acknowledged that the ALJ at issue in the case was illegally appointed).

## 2. *The ALJ Hearing and Appeals Process*

The APA outlines the steps and processes generally available to litigants in an agency proceeding.<sup>41</sup> SEC ALJs' authority is as broad as provided for by the APA.<sup>42</sup> In an agency hearing, an ALJ has the authority to:

(1) Administer oaths and affirmations; (2) Issue subpoenas;<sup>43</sup> (3) Rule on offers of proof; (4) Examine witnesses; (5) Regulate the course of a hearing; (6) Hold pre-hearing conferences; (7) Rule upon motions; and (8) Unless waived by the parties, prepare an initial decision containing the conclusions as to the factual and legal issues presented, and issue an appropriate order.<sup>44</sup>

Following the issuance of an SEC ALJ's initial decision, a party has a right to appeal that decision to the Commissioners,<sup>45</sup> who review it *de novo*.<sup>46</sup> Importantly, even if an initial decision is not appealed or reviewed, it does not become final until the Commission "issue[s] an order that the decision has become final."<sup>47</sup> Prior to appealing an adverse agency ruling in federal court, a party must first appeal to the Commission, since a final order from the Commission is a prerequisite to judicial review.<sup>48</sup> To appeal a final order to a federal court of appeals, a litigant must do so within sixty days.<sup>49</sup>

## II. CONSTITUTIONAL CHALLENGES TO THE SEC ENFORCEMENT SCHEME

The SEC's ability to bring individual in-house enforcement actions has prompted numerous protests concerning the fairness and constitutionality of permitting the same case to be brought either in-house or in federal court. Litigants steered into in-house hearings complain that the amount of process afforded to them diverges considerably from that which a litigant

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<sup>41</sup> See 5 U.S.C. § 557(b) (2012) ("When the presiding employee makes an initial decision, that decision then becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule.").

<sup>42</sup> See 17 C.F.R. § 201.111 (1995) ("No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the Administrative Procedure Act.") (internal citation omitted).

<sup>43</sup> Although an ALJ may issue a subpoena, he or she is unable to compel compliance; that requires a district court order. 15 U.S.C. § 78u(c) (2012) (establishing that in cases involving a refusal to obey a Commission-issued subpoena, the Commission must seek recourse from a federal district court).

<sup>44</sup> 17 C.F.R. § 200.14(a) (1995).

<sup>45</sup> *Id.* §§ 201.360(d), 201.410(a).

<sup>46</sup> *Id.* § 201.411(a).

<sup>47</sup> *Id.* § 201.360(d)(2).

<sup>48</sup> *Id.* § 201.410(e).

<sup>49</sup> 15 U.S.C. § 78y(a) (2012).



receives in federal court.<sup>50</sup> Moreover, even the most complex cases must be completed within 300 days of filing.<sup>51</sup> Rather than undergo a truncated, procedurally incomplete hearing, some have challenged the proceedings in federal district court on Due Process and Equal Protection grounds.<sup>52</sup> More recently, litigants have contested ALJs' authority to adjudicate their claims by arguing that ALJs are unconstitutionally shielded from the President's removal power and were not properly appointed under Article II's Appointments Clause.<sup>53</sup> Prior to determining the merits of these challenges, jurisdiction first must be established, which, this Comment contends, at least arguably exists, although no court of appeals to decide the issue has found jurisdiction.<sup>54</sup>

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<sup>50</sup> See Complaint for Declaratory and Injunctive Relief at 23–25, *Hill v. SEC*, 114 F. Supp. 3d 1297 (N.D. Ga. 2015) (No. 1:15-cv-01801-LMM) (listing the numerous ways in which administrative proceedings differ from civil proceedings in federal district courts).

<sup>51</sup> 17 C.F.R. § 201.360(a)(2) (1995).

<sup>52</sup> See, e.g., *Jarkesy v. SEC*, 803 F.3d 9, 14 (D.C. Cir. 2015) (alleging a “Fifth Amendment Due Process Clause violation based on the Commission’s supposed prejudgment of their charges”); *Bebo v. SEC*, 799 F.3d 765, 768 (7th Cir. 2015), *cert. denied*, 136 S. Ct. 1500 (2016) (alleging that Dodd-Frank “provides the SEC ‘unguided’ authority to choose which respondents will and which will not receive the procedural protections of a federal district court, in violation of equal protection and due process guarantees”); *Chau v. SEC*, 72 F. Supp. 3d 417, 420 (S.D.N.Y. 2014) (alleging that “the SEC’s choice to pursue them administratively, as opposed to suing them in a United States District Court, [had] deprive[d] them of their rights to due process and equal protection of law”); *Altman v. SEC*, 687 F.3d 44, 45 (2d Cir. 2012) (“Altman contends that the actions of the Commission deprived him of equal protection and due process . . . .”); *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 506–07 (S.D.N.Y. 2011) (alleging “that the SEC’s unjustified decision to deprive Gupta, alone, of the opportunity to contest these allegations in federal court” was “in violation of the Equal Protection Clause”); see *infra* Part IV.A.

<sup>53</sup> See, e.g., *Duka v. SEC*, 103 F. Supp. 3d 382, 385 (S.D.N.Y. 2015) (alleging that ALJs are “insulated unlawfully from oversight by the President”), *abrogated by* *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (“Tilton II”); *Tilton v. SEC*, No. 15-CV-2472-RA, 2015 WL 4006165, at \*1–2 (S.D.N.Y. June 30, 2015) (“Tilton I”) (arguing that the appointment of SEC ALJs violated Article II’s Appointments Clause), *aff’d Tilton II*, 824 F.3d; *Hill v. SEC*, 114 F. Supp. 3d 1297, 1304 (N.D. Ga. 2015) (“Hill I”) (asserting “that the proceeding violates Article II of the Constitution because ALJs are protected by two layers of tenure protection”), *rev’d Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) (“Hill II”); *Gray Fin. Grp., Inc. v. SEC*, 166 F. Supp. 3d 1335, 1349 (N.D. Ga. 2015) (alleging “the ALJ’s appointment violates the Appointments Clause of Article II”), *rev’d sub nom. Hill II*, 825 F.3d; *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1312 (N.D. Ga. 2015) (alleging that “the ALJ’s appointment violates the Appointments Clause of Article II because he was not appointed by the President, a court of law, or a department head”); *Timbervest, LLC v. SEC*, No. 1:15-CV-2106-LMM, 2015 WL 7597428, at \*7 (N.D. Ga. Aug. 4, 2015) (arguing that the ALJ at issue was unconstitutionally shielded from removal by the President and that he was not properly appointed); *Bennett v. SEC*, 151 F. Supp. 3d 632, 634 (D. Md. 2015) (alleging that SEC ALJs are unconstitutionally protected in light of the fact that they can only be removed “for good cause”). For further discussion, see *infra* Parts II.B & II.C.

<sup>54</sup> See *Hill II*, 825 F.3d at 1241 (holding that the district court lacked subject-matter jurisdiction, and asserting that its holding was consistent with those of other circuits).

### A. *Establishing Federal Court Jurisdiction*

Traditionally, a litigant may not seek review of an agency action prior to the exhaustion of administrative remedies, provided the agency's authorizing statute requires it.<sup>55</sup> Here, some individuals subject to SEC proceedings have opted to raise the ALJ appointments issue in agency hearings, rather than sue the SEC in federal court, thereby avoiding this jurisdictional issue. In *In re Raymond J. Lucia Cos.*, the SEC Commissioners—mirroring the SEC's position in federal court—found (not surprisingly) that there was no Appointments Clause violation, since ALJs are not inferior officers.<sup>56</sup> Two Commissioners dissented.<sup>57</sup> The D.C. Circuit similarly found no Appointments Clause violation.<sup>58</sup>

However, most plaintiffs who have raised Appointments Clause challenges opted to sue the SEC in federal district court.<sup>59</sup> Since the challenged proceedings stem from an agency whose authorizing statute provides for exclusive remedies to an adversely effected party,<sup>60</sup> a federal court first must determine whether it has subject-matter jurisdiction to resolve the claim prior to the exhaustion of those remedies.<sup>61</sup> Although the Supreme Court has not addressed whether jurisdiction exists, the D.C. and Seventh Circuits found no jurisdiction, although no Appointments Clause challenges were raised in these cases.<sup>62</sup> However, Appointments Clause challenges were raised in the Second, Fourth and Eleventh Circuits. The

<sup>55</sup> See *Woodford v. Ngo*, 548 U.S. 81, 88 (2006) (internal citation omitted) (“The doctrine of exhaustion of administrative remedies is well established in the jurisprudence of administrative law.”)

<sup>56</sup> *Raymond J. Lucia Cos.*, Exchange Act Release No. 75837, 2015 WL 5172953, at \*2, 23 (Sept. 3, 2015).

<sup>57</sup> See Public Statement, SEC, Opinion of Commissioner Gallagher and Commissioner Piowar, Dissenting from the Opinion of the Commission (Oct. 2, 2015), <http://www.sec.gov/news/statement/dissenting-opinion-gallagher-piowar.html> (“Even though the Commission is free to express its views on Constitutional issues, we recognize and believe it is appropriate that Article III federal judges ultimately resolve this issue.”).

<sup>58</sup> *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 280, 289, 296 (D.C. Cir. 2016).

<sup>59</sup> See, e.g., cases cited *supra* note 53.

<sup>60</sup> See 15 U.S.C. § 78y(a)(1) (2012) (“A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review in the United States Court of Appeals.”).

<sup>61</sup> See generally *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41 (1938); see also *Sims v. Apfel*, 530 U.S. 103, 110 (2000) (“Where the parties are expected to develop the issues in an adversarial administrative proceeding, it seems to us that the rationale for requiring issue exhaustion is at its greatest.”); *McKart v. United States*, 395 U.S. 185, 194 (1969) (“[I]t is normally desirable to let the agency develop the necessary factual background upon which decisions should be based. . . . The courts ordinarily should not interfere with an agency until it has completed its action, or else has clearly exceeded its jurisdiction.”).

<sup>62</sup> See generally *Jarkesy v. SEC*, 803 F.3d 9 (D.C. Cir. 2015); *Bebo v. SEC*, 799 F.3d 765 (7th Cir. 2015).

Second and Eleventh Circuits found no jurisdiction, and an appeal before the Fourth Circuit is still pending.<sup>63</sup> The Fourth Circuit declined to stay agency proceedings pending the outcome of the appeal.<sup>64</sup>

When gauging the persuasiveness of the decisions that ruled on the jurisdictional question, it is helpful to distinguish between those cases that have raised Appointments Clause challenges and those that have not. The former cases more convincingly can claim to be wholly collateral to the agency hearing and outside its scope of expertise, as I argue below.

Courts have been less willing to find jurisdiction in cases that lack an Appointments Clause challenge.<sup>65</sup> Courts have ruled that jurisdiction does not exist in cases raising Due Process or Equal Protection challenges because they are not collateral to the suit or outside the scope of the SEC's expertise, and "a finding of preclusion does not foreclose all meaningful judicial review,"<sup>66</sup> since an appellate court can remand the case if it finds that Due Process was not afforded.<sup>67</sup>

Beginning in mid-2015,<sup>68</sup> SEC litigants regularly challenged the constitutionality of the ALJs' appointments, which some district courts have

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<sup>63</sup> See generally *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) ("Tilton II"); *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) ("Hill II"); Notice of Appeal, *Bennett v. SEC*, 2016 WL 7321231 (4th Cir. Dec. 21, 2015) (No. 15-2584).

<sup>64</sup> Order, *Bennett*, 2016 WL 7321231, (No. 15-2584) ("Upon consideration . . . the court denies the motion to expedite and for injunctive relief pending appeal.").

<sup>65</sup> See *Jarkesy*, 803 F.3d at 20–22 (noting that, unlike in *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 496 (2010), plaintiff "would not have to erect a Trojan-horse challenge to an SEC rule or 'bet the farm' by subjecting himself to unnecessary sanction under the securities laws" and that his claims concerned "substantive or procedural deficiencies in the Commission's enforcement of the securities laws against him," which were not collateral to the proceeding); *Bebo*, 799 F.3d at 775 ("We see no evidence from the statute's text, structure, and purpose that Congress intended for plaintiffs like Bebo who are already subject to ongoing administrative enforcement proceedings to be able to stop those proceedings by challenging the constitutionality of the enabling legislation or the structural authority of the SEC."); *Chau v. SEC*, 72 F. Supp. 3d 417, 425 (S.D.N.Y. 2014) ("This Court's jurisdiction is not an escape hatch for litigants to delay or derail an administrative action when statutory channels of review are entirely adequate."). But see *Gupta v. SEC*, 796 F. Supp. 2d 503, 513–14 (S.D.N.Y. 2011) (denying a motion to dismiss an equal protection claim on the grounds that the complaint "would state a claim even if Gupta were entirely guilty of the charges made against him" because his claims were wholly collateral to the underlying insider trading allegations).

<sup>66</sup> *Bebo*, 799 F.3d at 767.

<sup>67</sup> See *Jarkesy*, 803 F.3d at 22 ("[S]hould the record in the administrative proceeding prove inadequate to the court of appeals considering his attacks on the Commission's final order, that court always has the option of remanding to the agency for further factual development.") (internal quotation marks omitted).

<sup>68</sup> Allison Frankel, *Shadden's New Theory on Why SEC In-House Judges Are Unconstitutional*, REUTERS (Apr. 2, 2015), <http://blogs.reuters.com/alison-frankel/2015/04/02/skaddens-new-theory-on-why-sec-in-house-judges-are-unconstitutional>.

found sufficient to establish jurisdiction.<sup>69</sup> Because the Appointments Clause challenge is less clearly connected to any aspect of the underlying substantive claims, it has a stronger argument that the issue is not one Congress intended to limit from a district court's jurisdiction. Indeed, the plaintiff in *Hill v. SEC* tried to raise the challenge before an ALJ, but the ALJ ruled that he lacked the authority to rule on it and, as such, the plaintiff was forced either to wait for a final ruling—without the chance to have his constitutional challenge heard—or to seek an injunction in federal court.<sup>70</sup> Further, appellate review of a final SEC order offers no relief, since, as plaintiffs argue, they “will have already suffered an irreparable injury by the time he gets to the Court of Appeals on account of enduring an unconstitutional administrative hearing.”<sup>71</sup>

In *Thunder Basin Coal Co. v. Reich*, the Supreme Court discussed several considerations that are useful in determining whether Congress intended to foreclose district court jurisdiction over a collateral constitutional challenge or to allow a litigant to bypass the administrative process.<sup>72</sup> As instructed in *Thunder Basin*, a court may assume that Congress did not intend to limit jurisdiction if “a finding of preclusion could foreclose all meaningful judicial review,” if the issue is “‘wholly collateral’ to a statute’s review provisions,” and if the substance of the claim lies “outside the agency’s expertise.”<sup>73</sup> The Court also emphasized that “[w]hether a statute is intended to preclude initial judicial review is determined from the statute’s language, structure, and purpose.”<sup>74</sup>

The Court recently employed this test in *Free Enterprise Fund v. Public Co. Accounting Oversight Board* and in *Elgin v. Department of the Treasury*,<sup>75</sup> separating the considerations into three distinct factors.<sup>76</sup> The reasoning employed in both cases is instructive in trying to determine how the Court

69 See *Hill v. SEC*, 114 F. Supp. 3d 1297, 1305–10 (N.D. Ga. 2015) (“Hill I”) (finding the plaintiff’s Appointments Clause claim gave rise to subject-matter jurisdiction because the plaintiff did not merely challenge the propriety of the SEC’s decision, but disputed the SEC’s constitutional authority).

70 Brief of Appellee at 4, *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) (“Hill II”) (No. 15-12831).

71 *Id.* at 16; cf. *Matthews v. Eldridge*, 424 U.S. 319, 330 (1976) (holding that jurisdiction is proper where the “constitutional challenge is entirely collateral to [the] substantive claim of entitlement”).

72 *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 207–18 (1994).

73 *Id.* at 212–13.

74 *Id.* at 207.

75 *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 496 (2010); *Elgin v. Dep’t of the Treasury*, 132 S. Ct. 2126, 2133–36 (2012).

76 *Free Enter. Fund*, 561 U.S. 477, 489 (2010).

would rule in the matter of the SEC's ALJs. *Tilton v. SEC* and *Hill* also referenced these cases to help them decide this issue.<sup>77</sup>

### 1. Meaningful Judicial Review

Meaningful judicial review is the most difficult factor on which to predict how the Court would rule and likely would determine the outcome of the challenge. As in *Free Enterprise*, the appeals statute in question is 15 U.S.C. § 78y.<sup>78</sup> In *Free Enterprise*, the Court ruled that no meaningful judicial review existed.<sup>79</sup> There, petitioners were subject to an investigation, but the PCAOB ultimately did not issue any sanctions.<sup>80</sup> As such, there was no opportunity to challenge its constitutionality.<sup>81</sup> The Court rejected the government's argument that the plaintiffs lacked jurisdiction because they needed to wait for an adverse ruling.<sup>82</sup> The Court ruled that no "meaningful avenue of relief" exists where a plaintiff must "bet the farm . . . by taking the violative action before testing the validity of the law."<sup>83</sup>

The case of the SEC's ALJs is distinguishable from *Free Enterprise* because, here, the SEC already had initiated enforcement actions against each plaintiff. Thus, the only measurable harm the current plaintiffs would incur by having to first undergo an agency proceeding is the expense of litigation, which is insufficient to establish jurisdiction.<sup>84</sup> Moreover, as the Second Circuit noted in *Tilton II*, "some—but not all—of the PCAOB's regulatory actions required SEC approval in the form of a final Commission order."<sup>85</sup> Thus not all PCAOB action was subject to the appeals process described under § 78y, which only covers Commission orders.<sup>86</sup> This is seemingly distinguishable from the present case where every ALJ decision is subject to review by the Commission and, ultimately, a federal court of appeals.

Plaintiffs also cite to *McNary v. Haitian Refugee Center* for the proposition that just because a statute requires exhaustion of administrative remedies, that does not necessarily mean that the act encompasses "general collateral

<sup>77</sup> See generally *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) ("Tilton II"); *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) ("Hill II").

<sup>78</sup> *Free Enter. Fund*, 561 U.S. at 489; *Hill II*, 825 F.3d at 1242.

<sup>79</sup> *Free Enter. Fund*, 561 U.S. at 490.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 490–91 (internal quotation marks omitted).

<sup>84</sup> See *Renegotiation Bd. v. Bannerkraft Clothing Co.*, 415 U.S. 1, 24 (1974) ("Mere litigation expense, even substantial and unrecoverable cost, does not constitute irreparable injury.").

<sup>85</sup> *Tilton v. SEC*, 824 F.3d 276, 283 (2d Cir. 2016) ("Tilton II").

<sup>86</sup> *Id.*

challenges to unconstitutional practices and policies.”<sup>87</sup> However, *McNary* is factually distinguishable from the present cases and is more closely analogous to *Free Enterprise*. In *McNary*, undocumented workers sought to challenge the denial of special worker status, but the agency only permitted challenges to that classification in deportation hearings, which would force individuals to “surrender themselves for deportation” in order to obtain a decision.<sup>88</sup> That is akin to having to “bet the farm by taking the violative action,” which, under *Free Enterprise*, is not an avenue for meaningful review.<sup>89</sup>

Here, the Eleventh Circuit and a divided Second Circuit held that there was an opportunity for meaningful review,<sup>90</sup> which the latter referred to as “the ‘most important’ *Thunder Basin* factor.”<sup>91</sup> These two courts disagreed with district courts that had reasoned that no meaningful review existed because litigants would still be required to undergo the very hearing whose constitutionality they were challenging and they would have already suffered the alleged harm, regardless of the outcome of the proceeding or a later appeal.<sup>92</sup> The *Tilton* dissent agreed that no meaningful review existed and also noted that because most claims end in settlement, “it might well be that choosing to litigate is, in fact, equivalent to ‘betting the farm.’”<sup>93</sup>

In reversing the lower courts, these Circuit Courts relied on *Elgin* to support that no jurisdiction exists.<sup>94</sup> However, *Elgin*, like *Free Enterprise*, is distinguishable. In *Elgin*, the Court found that a district court lacked jurisdiction because review was available in the Federal Circuit.<sup>95</sup> Under the Civil Service Reform Act (“CSRA”), federal employees are permitted to “obtain administrative and judicial review of specified adverse employment actions.”<sup>96</sup> Following a hearing before an ALJ,<sup>97</sup> any employee “against

87 See, e.g., Brief of Appellee at 21, *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) (“*Hill II*”) (No. 15-12831) (quoting *McNary v. Haitian Refugee Ctr.*, 498 U.S. 479, 494 (1991)).

88 *McNary*, 498 U.S. at 496–97.

89 *Free Enter. Fund*, 561 U.S. at 490–91 (internal quotation marks omitted).

90 *Hill II*, 825 F.3d at 1250; *Tilton II*, 824 F.3d at 283, 87.

91 *Tilton II*, 824 F.3d at 282 (quoting *Bebo v. SEC*, 799 F.3d 765, 774–75 (7th Cir. 2015)).

92 See *Gray Fin. Grp. v. SEC*, 166 F. Supp. 3d 1335, 1345 (N.D. Ga. 2015) (“Because the courts of appeals cannot enjoin an unconstitutional administrative proceeding which has already occurred, those claims would be moot and the meaningful review *Thunder Basin* contemplates would be missing.”); *Duka v. SEC*, 103 F. Supp. 3d 382, 391 (S.D.N.Y. 2015) (“Simply put, there would be no proceeding to enjoin.”).

93 *Tilton II*, 824 F.3d at 298 n.5 (2d. Cir. 2016) (Droney, J., dissenting) (internal quotation marks omitted).

94 *Id.* at 279, 287–91 (majority opinion) (agreeing with the district court below when it “relied in part on *Elgin*” to determine that it lacked jurisdiction and citing *Elgin* in deciding two of the three *Thunder Basin* factors).

95 *Elgin v. Dep’t of the Treasury*, 132 S. Ct. 2126, 2139 (2012).

96 *Id.* at 2130.

97 *Id.* at 2131.

whom an action is taken” may obtain internal review and, if “aggrieved by a final order,” may appeal *exclusively* to the Federal Circuit.<sup>98</sup> In *Elgin*, petitioners were former federal employees who were fired for failing to comply with the Military Selective Service Act and as a result, were statutorily barred from federal employment in executive agencies.<sup>99</sup> Due to this absolute statutory bar on federal employment, the ALJ dismissed the claim for lack of jurisdiction.<sup>100</sup> Petitioners then sought a declaratory judgment in district court rather than challenge the ruling before the Merit Systems Protection Board (“MSPB”) or in the Federal Circuit.<sup>101</sup> *Elgin* held that meaningful review was available in the Federal Circuit, “an Article III court fully competent to adjudicate petitioners’ claims that Section 3328 and the Military Selective Service Act’s registration requirement are unconstitutional.”<sup>102</sup>

Unlike *Elgin*, the challenge here is not to any SEC ALJ decision, but to the constitutionality of the proceeding itself, in light of the ALJ’s defective appointment. By contrast, in *Elgin*, petitioners challenged an ALJ’s determination that he lacked jurisdiction and they were arguing that the ALJ should hear their claims. If, on appeal, the Federal Circuit had found that jurisdiction existed, petitioners would not have contested the agency proceeding. Thus, there are ways to distinguish *Free Enterprise*, *McNary* and *Elgin* and a colorable argument exists for both sides. Nonetheless, it is not clear that litigants have met the high bar needed to establish that meaningful review does not exist. In sum, “post-proceeding relief, although imperfect, suffices to vindicate the litigant’s constitutional claim”<sup>103</sup> since a court of appeals can “vacate a Commission order in whole, relieving the respondents of any liability.”<sup>104</sup> Ultimately, it is uncertain how the Court will rule.

## 2. Wholly Collateral

The Court is likely to find that the Appointments Clause challenge is wholly collateral to the underlying SEC action. In *Free Enterprise*, the Court held that a wholly collateral attack not challenging any particular agency

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<sup>98</sup> *Id.* at 2134.

<sup>99</sup> *Id.* at 2131.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 2137.

<sup>103</sup> *Tilton v. SEC*, 824 F.3d. 276, 285 (2d Cir. 2016) (“Tilton II”). *But see id.* at 299 (Droney, J., dissenting) (arguing that *Free Enterprise* “considers the very process of enforcement by an unconstitutional body to be an injury that can be relevant to the determination of whether post-proceeding review is ‘meaningful’”).

<sup>104</sup> *Hill v. SEC*, 825 F.3d 1236, 1247 (11th Cir. 2016) (“Hill II”) (citing 15 U.S.C. § 78y(a)(3)).

ruling may be brought prior to the exhaustion of administrative remedies.<sup>105</sup> The Court rejected the government's argument that plaintiffs could have and should have challenged in an agency hearing the PCAOB's "auditing standards, registration requirements, or other rules," since the objection was "to the Board's existence, not to any of its auditing standards."<sup>106</sup> In *Elgin*, the challenge was not wholly collateral because the "petitioners' constitutional claims are the vehicle by which they seek to reverse the removal decisions, to return to federal employment, and to receive the compensation," which "is precisely the type of personnel action regularly adjudicated by the MSPB and the Federal Circuit within the CSRA scheme."<sup>107</sup> Here, as in *Free Enterprise*, the challengers object to the very existence of the proceeding, not to any specific decision or rule, which is a wholly collateral issue.

*Hill* held that that this factor and the next "do not cut strongly either way,"<sup>108</sup> whereas *Tilton* held that "a claim is not wholly collateral if it has been raised in response to, and so is procedurally intertwined with, an administrative proceeding—regardless of the claim's substantive connection to the initial merits dispute."<sup>109</sup> However, as the *Tilton* dissent persuasively argued, the majority improperly focused on the procedural—rather than the substantive—merits of the constitutional claim, which runs contrary to the Court's analysis in *Thunder Basin*, *Free Enterprise*, and *Elgin*.<sup>110</sup> The dissent further noted that if—as the majority held—no challenge that could end an ongoing agency proceeding could ever be considered wholly collateral, that interpretation "would swallow the rule, for there would no longer be any need to evaluate the substance of a claim as long as the claim could somehow serve to end administrative proceedings in a plaintiff's favor."<sup>111</sup> Unlike *Elgin*, where the claim related to the substance of the act itself, here, the Appointments Clause claim has nothing to do with the enforcement of securities law and is wholly collateral.

### 3. Outside the Agency's Expertise

The Court is also likely to find that this challenge is outside the SEC's expertise. The Appointments Clause claim—unlike a ruling on a subpoena

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<sup>105</sup> See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 489 (2010) ("The Government [incorrectly] reads § 78y as an exclusive route to review.").

<sup>106</sup> *Id.* at 490.

<sup>107</sup> *Elgin*, 132 S. Ct. at 2139–40.

<sup>108</sup> *Hill II*, 825 F.3d at 1250.

<sup>109</sup> *Tilton v. SEC*, 824 F.3d 276, 287 (2d Cir. 2016) ("*Tilton II*").

<sup>110</sup> *Id.* at 292 (Droney, J., dissenting).

<sup>111</sup> *Id.* at 295.



or a discovery motion, among others<sup>112</sup>—is not within the SEC's expertise of investigating securities fraud or insider trading allegations, as even courts that found no jurisdiction have held.<sup>113</sup> Rather, "the statutory questions involved do not require 'technical considerations of [agency] policy' [and] are instead standard questions of administrative law."<sup>114</sup> *Tilton* and *Hill* held that the SEC could bring its general expertise to bear by finding that no securities violation occurred, which would moot the Appointments Clause claim.<sup>115</sup> But that reasoning is unconvincing, since it ignores the merits of the underlying challenge and focuses only on the merits of the securities claim with no clear basis that that interpretation is consistent with Supreme Court precedent.

#### 4. *Weighing the Thunder Basin Factors*

To date, no court has ruled on how much weight to give each *Thunder Basin* factor, which will be necessary if the factors are not decided the same way.<sup>116</sup> If, as *Tilton* and *Hill* argue, the meaningful judicial review factor is the most important, the Court may find no jurisdiction. If, however, they are to be weighed equally, then jurisdiction may exist.

#### B. *Determining Whether SEC ALJs Are Inferior Officers*

This section addresses whether ALJs are inferior officers or mere employees, since the Appointments Clause is only relevant if they are inferior officers. Because the SEC readily concedes that it does not appoint its ALJs,<sup>117</sup> if SEC ALJs are inferior officers—as this Comment argues they may be—then their appointments violate the Appointments Clause.

The Constitution states that the President:

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112 *Cf.* *Chau v. SEC*, 72 F. Supp. 3d 417, 428 (S.D.N.Y. 2014) ("[The plaintiffs'] due process claim has been that the SEC's procedural rules . . . are unfair in light of the facts and circumstances of [their] case.") (alteration in original) (internal quotation marks omitted).

113 *See Tilton v. SEC*, No. 15-CV-2472-RA, 2015 WL 4006165, at \*12 (S.D.N.Y. June 30, 2015) ("*Tilton I*") ("[T]he particular constitutional questions here may not be within the SEC's expertise.").

114 *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 491 (2010) (quoting *Johnson v. Robinson*, 415 U.S. 361, 373 (1974) (first alteration in original)).

115 *Hill v. SEC*, 825 F.3d 1236, 1250 (11th Cir. 2016) ("*Hill II*"); *Tilton v. SEC*, 824 F.3d 276, 290 (2d Cir. 2016) ("*Tilton II*").

116 *Cf. Tilton II*, 824 F.3d at 299 (Droney, J., dissenting) ("I am unpersuaded that the 'meaningful judicial review' prong has enough weight to overpower the other two factors and result in a finding of no jurisdiction.")

117 *See Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 283 (D.C. Cir. 2016) ("The Commission has acknowledged the ALJ was not appointed as the Clause requires . . .").

shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . Officers of the United States, whose Appointments . . . shall be established by Law; but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.<sup>118</sup>

In *Free Enterprise*, the Court held that “[b]ecause the Commission [SEC] is a freestanding component of the Executive Branch, not subordinate to or contained within any other such component, it constitutes a ‘Department’ for the purposes of the Appointments Clause.”<sup>119</sup> Even assuming ALJs are inferior officers, had the Commissioners appointed its ALJs there would be no constitutional infirmity; however, the SEC does not, in fact, appoint its ALJs.

Officers exercise “significant authority pursuant to the laws of the United States.”<sup>120</sup> The President appoints principal officers “with the advice and consent of the Senate.”<sup>121</sup> The difference between an inferior officer and a principal officer has not been fully clarified,<sup>122</sup> but the distinction is not crucial for this Comment. That is because ALJs’ initial decisions are reviewed de novo by the Commissioners, thus ALJs are at most inferior officers. Of note, “Heads of Departments” may appoint inferior officers.<sup>123</sup> By contrast, “[e]mployees are lesser functionaries subordinate to officers,” and may be hired in any manner the agency decides.<sup>124</sup>

In *Free Enterprise*, the dissent listed positions that the Supreme Court has previously found to be inferior officers.<sup>125</sup> Although the majority sidestepped whether ALJs are inferior officers,<sup>126</sup> the dissent argued that

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118 U.S. CONST. art. II, § 2, cl. 2.

119 561 U.S. at 511 (internal alteration omitted); see also Kent Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 810 (2013) (noting that not all executive agencies are also departments).

120 *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (per curiam).

121 U.S. CONST. art. II, § 2, cl. 2.

122 See *Edmond v. United States*, 520 U.S. 651, 661 (1997) (“Our cases have not set forth an exclusive criterion for distinguishing between principal and inferior officers . . .”); Nick Bravin, Note, *Is Morrison v. Olson Still Good Law? The Court’s New Appointments Clause Jurisprudence*, 98 COLUM. L. REV. 1103, 1114 (1998) (“Early Supreme Court attempts to define the term ‘officer’ provide inexact, if any, judicially manageable standards.”).

123 U.S. CONST. art. II, § 2, cl. 2.

124 *Buckley*, 424 U.S. at 126 n.162.

125 See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 540 (2010) (Breyer, J., dissenting) (noting that the Court had previously held that “officers” included a district court clerk, clerks in various executive departments, an assistant treasurer’s clerk, an assistant surgeon, a cadet-engineer, election monitors, United States attorneys, federal marshals, military judges, Article I judges, and the Department of Transportation’s general counsel, among others).

126 See *id.* at 507 n.10 (“[O]ur holding . . . does not address that subset of independent agency employees who serve as administrative law judges. . . . Whether administrative law judges are necessarily ‘Officers of the United States’ is disputed.”) (majority opinion).

“[r]eading the criteria above as stringently as possible, I still see no way to avoid sweeping hundreds, perhaps thousands of high-level Government officials within the scope of the Court’s holding, putting their job security and their administrative actions and decisions constitutionally at risk.”<sup>127</sup>

In *Morrison v. Olson*, the Supreme Court attempted to delineate certain factors that are relevant to determine an individual’s constitutional status. The Court held that no Appointments Clause violation existed with respect to an independent counsel who was appointed by a “Court[] of Law”<sup>128</sup> to investigate and prosecute high-ranking government officials, since she was an inferior officer—not a principal officer—and did not need to be appointed with the advice and consent of the Senate.<sup>129</sup> To determine an officer’s status, the Supreme Court identified four core factors to consider: removability by a higher executive branch official; empowerment to perform only limited duties; limited jurisdiction; and limited tenure.<sup>130</sup> However, the Court did not apply the factors, stating that “[w]e need not attempt here to decide exactly where the line falls between the two types of officers, because in our view appellant clearly falls on the ‘inferior officer’ side of that line.”<sup>131</sup>

Less than ten years later, in *Edmond v. United States*, the Court returned to this issue and defined an inferior officer as one “whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate.”<sup>132</sup> The Court ruled that Coast Guard Court of Criminal Appeals judges were inferior officers, since, among other reasons, the Judge Advocate General and the Court of Appeals for the Armed Forces supervised them.<sup>133</sup>

Unlike *Morrison* and *Edmond*, which differentiated between principal and inferior officers, *Freitag v. Commissioner*<sup>134</sup> distinguished between an inferior officer and an employee and focused on the “degree of authority exercised” and, secondarily, on the ability to render a final decision.<sup>135</sup> In *Raymond J. Lucia Cos. v. SEC*,<sup>136</sup> the D.C. Circuit became the first appellate court to apply this test to SEC ALJs. However, *Lucia* created its own test for who is an inferior officer that, this Comment argues, is not entirely consistent with the

<sup>127</sup> *Id.* at 540–41 (Breyer, J., dissenting).

<sup>128</sup> See U.S. CONST. art. II, § 2, cl. 2.

<sup>129</sup> *Morrison v. Olson*, 487 U.S. 654, 671, 676 (1988).

<sup>130</sup> Bravin, *supra* note 122, at 1116 (citing *Morrison*, 487 U.S. at 671–72).

<sup>131</sup> *Morrison*, 487 U.S. at 671. Indeed, the dissent criticized this lack of guidance and its failure to consider the separation-of-powers concerns that would arise from the decision. *Id.* at 704 (Scalia, J., dissenting).

<sup>132</sup> 520 U.S. 651, 663 (1997).

<sup>133</sup> *Id.* at 664, 666.

<sup>134</sup> 501 U.S. 868 (1991).

<sup>135</sup> *Id.* at 880–82.

<sup>136</sup> 832 F.3d 277 (D.C. Cir. 2016).

test articulated by the Supreme Court in *Freytag*. *Lucia* stated that “the main criteria for drawing the line between inferior Officers and employees not covered by the Clause are (1) the significance of the matters resolved by the officials, (2) the discretion they exercise in reaching their decisions, and (3) the finality of those decisions.”<sup>137</sup> However, *Freytag* placed a greater emphasis on the first two factors only.<sup>138</sup>

### 1. *ALJs Wield Considerable Discretion*

In *Freytag*, the Court determined that Tax Court Special Trial Judges (“STJs”), who could be appointed by the Tax Court Chief Judge and who were tasked with assisting Tax Court judges, were inferior officers.<sup>139</sup> The Court reasoned that STJs were inferior officers because “the degree of authority exercised . . . [was] so significant that it was inconsistent with the classification of lesser functionaries or employees.”<sup>140</sup> Although the government argued that STJs “lack[ed] authority to enter a final decision” in certain cases, the Court found that “this argument ignores the significance of the duties and discretion that special trial judges possess.”<sup>141</sup> The Court noted that “[t]he office of special trial judge is established by Law,” and that STJs “perform more than ministerial tasks. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. In the course of carrying out these important functions, the special trial judges exercise significant discretion.”<sup>142</sup>

In *Landry v. Federal Deposit Insurance Corp.*, the D.C. Circuit applied *Freytag* to address whether Federal Deposit Insurance Corporation (“FDIC”) ALJs are inferior officers.<sup>143</sup> The court recognized that, like *Freytag*’s STJs, an ALJ’s position is “established by Law, as are its specific duties, salary, and means of appointment.”<sup>144</sup> Further, ALJs also “take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders . . . [and] exercise significant discretion.”<sup>145</sup>

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<sup>137</sup> *Id.* at 285 (quoting *Tucker v. Comm’r*, 676 F.3d 1129, 1133 (D.C. Cir. 2012)).

<sup>138</sup> *Freytag*, 501 U.S. at 881.

<sup>139</sup> *Id.* 880–82.

<sup>140</sup> *Id.* at 881 (internal quotation marks omitted).

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 881–82 (internal quotation marks and citations omitted).

<sup>143</sup> 204 F.3d 1125, 1130–32 (D.C. Cir. 2000).

<sup>144</sup> *Id.* at 1133 (internal quotation marks omitted).

<sup>145</sup> *Id.* at 1134 (quoting *Freytag*, 501 U.S. 881–82); *see also* 17 C.F.R. § 200.14(a) (1995) (denoting the power that ALJs have when conducting agencies hearings); Barnett, *supra* note 119, at 811–12 (describing the powers that ALJs yield).

Although *Landry* ultimately held that ALJs are not inferior officers, there are reasons both to distinguish between SEC ALJs and FDIC ALJs and to question whether *Landry* was correctly decided, as discussed in more detail in the next subsection.

*Landry* recognized that FDIC ALJs wield considerable authority, similar to that exercised by STJs. Nonetheless, it distinguished between STJs and ALJs, reasoning that STJs could sometimes render final decisions, whereas ALJs could issue only “recommended findings of fact” and “recommended conclusions of law.”<sup>146</sup> Further, *Landry* noted that an STJ’s factual findings cannot be overturned unless they are clearly erroneous, whereas FDIC ALJs’ factual findings are reviewed de novo.<sup>147</sup>

Unlike the *Landry* majority, the concurrence argued that “[t]here are no relevant differences” between the functions of ALJs and STJs, recognizing that the Supreme Court did not make rendering final decisions a necessary condition for inferior officer status.<sup>148</sup> Like STJs, ALJs are established by law<sup>149</sup> and wield considerable authority and discretion,<sup>150</sup> which, it argued, was a more important consideration to the *Freitag* Court.<sup>151</sup>

SEC ALJs wield significant power—inconsistent with that of an employee—and they decide important agency matters. They

- (1) Administer oaths and affirmations; (2) Issue subpoenas; (3) Rule on offers of proof; (4) Examine witnesses; (5) Regulate the course of a hearing; (6) Hold pre-hearing conferences; (7) Rule upon motions; and (8) . . . prepare an initial decision containing the conclusions as to the factual and legal issues presented, and issue an appropriate order.<sup>152</sup>

Because SEC ALJs exercise comparable discretion with respect to STJs, they satisfy the first two *Lucia* elements that were focal to *Freitag*’s holding.<sup>153</sup> Thus, it is arguable that they, too, are inferior officers.

Notably, the D.C. Circuit in *Lucia*, relying largely on *Landry*, held that SEC ALJs are not inferior officers.<sup>154</sup> However, that court did not devote significant space to the issue of ALJ discretion. Rather, much of its analysis

<sup>146</sup> *Landry*, 204 F.3d at 1133 (internal citations and quotation marks omitted).

<sup>147</sup> *Id.* (citing Tax Ct. R. 183(c)).

<sup>148</sup> *Id.* at 1141 (Randolph, J., concurring).

<sup>149</sup> 17 C.F.R. § 200.14 (1995).

<sup>150</sup> See *Butz v. Economou*, 438 U.S. 478, 513 (1978) (“[T]he role of the modern . . . administrative law judge . . . is ‘functionally comparable’ to that of a judge.”); see also Barnett, *supra* note 119, at 798 (noting that the function of ALJs “closely parallels that of Article III judges”).

<sup>151</sup> *Landry*, 204 F.3d at 1142 (“It is true that the Supreme Court relied on this consideration; the last paragraph of the opinion quoted above indicates as much. What the majority neglects to mention is that the Court clearly designated this as an alternative holding.”)

<sup>152</sup> 17 C.F.R. § 200.14(a) (1995).

<sup>153</sup> See *supra* note 138 and accompanying text.

<sup>154</sup> See *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 285 (D.C. Cir. 2016) (“*Landry* is the law of the circuit.”).

focused on the finality issue and the scope of the Commission's review, which are discussed in the following section.

*2. That ALJs' Decisions Lack Finality and Are Reviewed De Novo Is Not Dispositive of Whether They Are Inferior Officers*

An adjudicator may still be an inferior officer even if his or her decisions are reviewed de novo and the decisions are not summarily final. Moreover, they are not required elements, contrary to *Lucia's* reading of *Freytag*.

a. Finality Is Not a Required Element of Inferior Officer Status

In *Freytag*, the Court buttressed its conclusion that STJs were inferior officers by noting that even if STJs' duties "under subsection (b) (4) were not as significant as we . . . have found them to be, our conclusion would be unchanged[.]" since under other parts of the statutory scheme, "the Chief Judge may assign [STJs] to render the decisions of the Tax Court."<sup>155</sup> Thus, even for the hearings over which an STJ could not render a final decision and for which he was a "mere employee with respect to [those] responsibilities," that did not "transform his status [as an inferior officer] under the Constitution."<sup>156</sup> While suggesting that final decision-making authority may be sufficient to make someone an inferior officer, this dictum does not suggest that finality is necessary.

The Supreme Court in *Freytag* focused first and foremost on "the significance of the duties and discretion" that STJs exercised, as did the *Landry* concurrence.<sup>157</sup> The *Landry* concurrence emphasized that an ALJ's discretion and authority—not its ability to render final decisions—is central to the determination that an ALJ is an inferior officer, and the fact that its decisions are reviewed by the agency "shows only that the ALJ shares the common characteristic of an 'inferior Officer.'"<sup>158</sup> Accordingly, it appears—as some commenters have argued—that the *Landry* concurrence "had the better argument,"<sup>159</sup> and that final decision making authority, although highly relevant, is not dispositive. The *Landry* majority's reading of *Freytag* and its reliance on *Freytag's* dictum seem misplaced.<sup>160</sup>

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<sup>155</sup> *Freytag v. Comm'r*, 501 U.S. 868, 882 (1991).

<sup>156</sup> *Id.*

<sup>157</sup> *Id.* at 881.

<sup>158</sup> *Landry v. FDIC*, 204 F.3d 1125, 1142 (D.C. Cir. 2000) (Randolph, J., concurring).

<sup>159</sup> Barnett, *supra* note 119, at 813.

<sup>160</sup> Indeed, this reading of *Freytag* is inconsistent with *Edmond*, which held that a judge was an inferior officer even though he "ha[d] no power to render a final decision . . . unless permitted to do so by other Executive officers." 520 U.S. 651, 665 (1997). Although *Free Enterprise* mentioned *Landry*, it declined to follow or reject it, simply citing it for the

Nonetheless, the D.C. Circuit in *Landry* emphasized the fact that STJs could render final decisions in delineated instances and used that to distinguish them from FDIC ALJs,<sup>161</sup> ignoring the central part of *Freytag*'s holding. Similarly, the D.C. Circuit in *Lucia* emphasized the lack of finality in its determination that SEC ALJs are not inferior officers.<sup>162</sup>

Even if *Landry* was correctly decided, SEC ALJs arguably can be distinguished from FDIC ALJs. FDIC ALJs render "recommendatory decisions," which "always require further agency action."<sup>163</sup> By contrast, in certain instances an SEC ALJ's decision can become the final agency decision.<sup>164</sup> Although this distinction appears compelling, the court in *Lucia* dismissed it, finding that "the difference between the FDIC's recommended decisions and the Commission's initial decisions is illusory."<sup>165</sup> It further stressed that the SEC "has retained full decision-making powers" and that an ALJ's initial decision becomes final "when, and only when, the Commission issues the finality order."<sup>166</sup> Thus, ALJs do not have the power "to act independently of the Commission, nor . . . do they have the power to bind third parties."<sup>167</sup> However, *Lucia*'s holding too quickly dismisses the fact that the SEC has the discretion to decline to review a decision in which there is no clearly erroneous factual or legal conclusion, unlike the FDIC.<sup>168</sup> This suggests that there is some meaningful distinction between the finality of an SEC ALJ's decision and that of an FDIC ALJ's.

#### b. The SEC's Scope of Review over an ALJ's Decision Does Not Render ALJs Employees

Additionally, the scope of review was not focal to *Freytag*'s inferior officer analysis. Nonetheless, *Landry* distinguished the scope and depth of review for STJ and ALJ non-final decisions to support its holding that ALJs are not

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proposition that whether ALJs are inferior officers was "disputed." 561 U.S. 477, 507 n.10 (2010).

<sup>161</sup> See *Landry*, 204 F.3d at 1134 (arguing that "in another way the [Supreme] Court laid exceptional stress on the STJs' final decisionmaking power").

<sup>162</sup> Raymond J. Lucia Cos. v. SEC, 832 F.3d 277, 284–88 (D.C. Cir. 2016).

<sup>163</sup> Timbervest, LLC v. SEC, 1:15–CV–2106–LMM, 2015 WL 7597428, at \*10 (N.D. Ga. Aug. 4, 2015) (citing 5 U.S.C. § 557(b) (2012)).

<sup>164</sup> 17 C.F.R. § 201.360(d)(2) (1995) ("If a party or aggrieved person entitled to review fails to file timely a petition for review or a motion to correct a manifest error of fact in the initial decision, and if the Commission does not order review of a decision on its own initiative, the Commission will issue an order that the decision has become final as to that party."); see 17 C.F.R. § 201.411(e) (1995) (stating that for ALJ decisions not subject to mandatory review, "the Commission may summarily affirm an initial decision").

<sup>165</sup> *Lucia*, 832 F.3d at 287 (internal quotation marks omitted).

<sup>166</sup> *Id.* at 286.

<sup>167</sup> *Id.*

<sup>168</sup> 17 C.F.R. § 201.411(b)(2) (1995).

inferior officers. *Landry* noted that, under the Tax Court rules, when reviewing an STJ's recommendation, "[d]ue regard shall be given to the circumstance that the [STJ] had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the [STJ] shall be presumed to be correct."<sup>169</sup> *Landry* also cited to *Edmond*, where the Court determined that military judges were inferior officers because "so long as there is some competent evidence . . . to establish each element of the offense beyond a reasonable doubt, the Court of Appeals for the Armed Forces will not reevaluate the facts," suggesting a very narrow scope of review.<sup>170</sup> By contrast, the FDIC Board may review "the entire record of the proceeding."<sup>171</sup> Here, the SEC Commission may set aside an initial decision based on "its judgment [of what is] proper and on the basis of the record," which suggests a less deferential standard of review than in *Freytag*.<sup>172</sup> As *Lucia* also noted, "[i]n either the FDIC or [SEC] system, issues of law and fact can go unreviewed," which supports the SEC's position that there is not as great a difference between the FDIC and SEC as has been argued.<sup>173</sup> However, *Landry* and *Lucia*'s emphasis on the scope of review arguably is misplaced, given that it was not a focal part of *Freytag*'s analysis and, indeed, was not even relevant to the Supreme Court's granting of certiorari.<sup>174</sup>

Moreover, the FDIC and SEC scope of review can be distinguished. Unlike the FDIC, the SEC does not review each initial decision de novo. Rather, it exercises discretion over how much and how searching a review to conduct.<sup>175</sup> The SEC may summarily affirm an initial decision if it believes that no further consideration is necessary, at which point the ALJ's decision becomes the SEC's final order.<sup>176</sup> Nonetheless, *Lucia* argued that the SEC's "scope of review is no more deferential than that of the FDIC Board."<sup>177</sup> But unlike the SEC, the FDIC must review all FDIC ALJ decisions, whereas, approximately 90% of the SEC's ALJs' initial decisions in 2014 and 2015 were not reviewed by the Commission.<sup>178</sup> That SEC hearings may be

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<sup>169</sup> Tax Ct. R. 183.

<sup>170</sup> *Edmond v. United States*, 520 U.S. 651, 665 (1997).

<sup>171</sup> 12 C.F.R. § 308.40(c)(1) (1995) (cited in *Landry v. FDIC*, 204 F.3d 1125, 1133 (D.C. Cir. 2000)).

<sup>172</sup> 17 C.F.R. § 201.411(a) (1995).

<sup>173</sup> *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 287–88 (D.C. Cir. 2016).

<sup>174</sup> See *Freytag v. Comm'r*, 501 U.S. 868, 874 n.3 (1991) (noting that the standard of review was "not relevant to [the Court's] grant of certiorari").

<sup>175</sup> 17 C.F.R. § 201.411(a)–(d) (1995).

<sup>176</sup> *Id.* § 201.411(e).

<sup>177</sup> *Lucia*, 832 F.3d at 288.

<sup>178</sup> Brief of Appellants at 30–31, *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277 (D.C. Cir. 2016) (No. 15-1345).



presided over by either ALJs or the Commission further exemplifies the power ALJs possess.<sup>179</sup>

Further, it is not clear that the distinction concerning the scope of review necessarily renders an ALJ a mere employee. As the Court held in *Edmond*, agency adjudicators can be inferior officers even if they “have no power to render a final decision.”<sup>180</sup> Accordingly, the *Landry* concurrence found the different scope of review to be “no distinction at all,” opining that review by a principal officer would merely render FDIC ALJs inferior officers.<sup>181</sup> Nonetheless, *Lucia*—like *Landry*—stressed that ALJs operate under the control of their agencies and were intended to be accountable to their agencies.<sup>182</sup> But the mere fact that ALJs operate under the control of an Officer does not determine whether they are employees or inferior officers.

Importantly, even where review is de novo, deference is still given to an ALJ’s credibility determination.<sup>183</sup> In general, when an agency reviews a hearing officer’s decision, it defers to the officer’s credibility findings unless the statute or regulation provides otherwise.<sup>184</sup> Such a determination can be

179 See 15 U.S.C. § 77u (2012) (“All hearings . . . may be held before the Commission or an officer or officers of the Commission designated by it.”); 17 C.F.R. § 201.101(a)(5) (1995) (“Hearing officer means an administrative law judge, a panel of Commissioners constituting less than a quorum of the Commission, [or] an individual Commissioner.”). As the *Hill* brief noted, the SEC’s website used to refer to ALJs as “independent judicial officers.” See Brief of Appellee at 42 n.15, *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2015) (No. 15-12831) (quoting SEC, Office of Administrative Law Judges, <http://www.sec.gov/alj>). Interestingly, that description has since been modified and now defines ALJs as “independent adjudicators.” SEC, Office of Administrative Law Judges, <http://www.sec.gov/alj> (last visited Oct. 30, 2016). On the other hand, the SEC states that the use of the term “hearing officer” does not mean Congress intended ALJs to be “Officers of the United States.” See Brief of Appellee at 41–42 n.7, *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2015) (“*Tilton II*”) (No. 15-2103). The D.C. Circuit agreed. See *Lucia*, 832 F.3d at 289 (noting that the statutory reference to “‘officers of the Commission’ in 15 U.S.C. § 77u” does not mean that “Congress intended these officers to be synonymous with ‘Officers of the United States’ under the Appointments Clause”). This argument seems compelling, since the APA refers to one who renders an initial decision as a “presiding employee.” See 5 U.S.C. §§ 554, 556, & 557 (2012).

180 *Edmond v. United States*, 520 U.S. 651, 665 (1997). In keeping with this test, the Supreme Court in *Ryder v. United States* noted that appellate military judges were inferior officers. 515 U.S. 177, 180 (1995).

181 *Landry v. FDIC*, 204 F.3d 1125, 1142 (D.C. Cir. 2000) (Randolph, J., concurring).

182 *Lucia*, 832 F.3d at 288–89.

183 See *Landry*, 204 F.3d at 1143 n.3 (Randolph, J., concurring) (emphasizing that “[d]e novo review does not mean that the ALJ’s recommended decisions are without influence”).

184 See *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 496 (1951) (stating that when the factfinder and the reviewing body reach opposite conclusions on a witness’s credibility, deference should be given to “an impartial, experienced examiner who has observed the witnesses and lived with the case [and] has drawn conclusions different from the Board’s”); *Bosma v. U.S. Dep’t of Agric.*, 754 F.2d 804, 808 (9th Cir. 1984) (holding that where “credibility is at issue or when findings of motive or purpose depend entirely on

overcome “only where the record contains substantial evidence for doing so.”<sup>185</sup> Indeed, the SEC itself has stated that it defers to its ALJs’ credibility findings “absent overwhelming evidence to the contrary.”<sup>186</sup> Further, in instances where mandatory review is not guaranteed, the Commission may decline review where there is no clearly erroneous factual finding or legal conclusion.<sup>187</sup> Thus, like *Freytag*, if there are some instances where ALJs’ decisions are final, that may make them inferior officers in all aspects of their job.

In fact, the *Landry* concurrence noted that magistrate judges perform similar functions to ALJs and that “[w]hen there is an objection to a magistrate’s findings and recommendations, the district judge—like the FDIC—must conduct *de novo* review,” but “[n]onetheless, it has long been settled that federal magistrates are ‘inferior Officers.’”<sup>188</sup> Thus, although ALJs’ decisions are reviewed *de novo*, they still may qualify as inferior officer, as do magistrates.

With that said, there is a distinction between the deference given to STJ decisions and those ALJ decisions that are subject to review. “[F]actfindings contained in [an STJ’s] report shall be presumed to be correct,”<sup>189</sup> whereas if SEC Commissioners do not agree on a disposition, “the initial decision shall be of no effect.”<sup>190</sup> *Lucia* emphasized this in reaching its ultimate conclusion, and the degree to which this matters may influence the outcome of the Court’s analysis.

Lastly, four of the eight current Supreme Court justices have suggested that ALJs are inferior officers.<sup>191</sup> This is a close issue and it is not entirely predictable which way the Court might rule. Under *Freytag* and *Edmond*,

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credibility, the decision of the ALJ will be given special weight”); Barnett, *supra* note 119, at 811–12 (noting that in some agencies, ALJ findings “are generally final”).

185 *In re Fuller*, Sec. Exchange Act Release No. 48406, 2003 WL 22016309, at \*7 (Aug. 25, 2003) (internal quotation marks omitted).

186 *In re Clawson*, Sec. Exchange Act Release No. 48143, 2003 WL 21539920, at \*2 (July 9, 2003) (“We accept [an ALJ’s] credibility finding, absent overwhelming evidence to the contrary”); *see also In re Pelosi*, Sec. Act Release No. 3805, 2014 W.L. 1247415, at \*2 (Mar. 27, 2014) (“The Commission gives considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses’ testimony and observing their demeanor.”) (internal quotation marks omitted).

187 17 C.F.R. § 201.411(b)(iii)(2) (1995).

188 *Landry*, 204 F.3d at 1143 (Randolph, J., concurring) (citing *Rice v. Ames*, 180 U.S. 371, 378 (1901)); *see also* Barnett, *supra* note 119, at 813 (discussing *Landry*).

189 *Ballard v. Comm’r*, 544 U.S. 40, 45 (2005) (internal quotation marks omitted).

190 17 C.F.R. § 201.411(f) (1995).

191 *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 542 (2010) (Breyer, J., dissenting, joined by Ginsburg & Sotomayor, JJ.) (“As Justice Scalia has observed, administrative law judges (ALJs) ‘are all executive officers.’”) (quoting *Freytag v. Comm’r*, 501 U.S. 868, 910 (1991)) (Scalia, J., concurring in part and concurring in the judgment, joined by Kennedy, J.).

ALJs seemingly fit the description of inferior officers. The implications would be very unsettling to the administrative state, however. Consequently, the Supreme Court may seek to avoid this result.

*C. ALJs' Double For-Cause Removal Does Not Infringe on Executive Power by Insulating ALJs from Removal*

Litigants have invoked *Free Enterprise* to argue that ALJs are also too far removed from the President's control,<sup>192</sup> but unlike in *Free Enterprise*, the removal power argument here is unlikely to succeed. The Constitution states that the President must "take Care that the Laws be faithfully executed."<sup>193</sup> To accomplish this, the President must be able to hold officers accountable and "have the possibility of directing discretionary legal duties, even those assigned to other officers."<sup>194</sup>

ALJs are only removable by the agency that appoints them "for good cause established and determined by the Merit Systems Protection Board on the record after opportunity for hearing."<sup>195</sup> Both SEC Commissioners and MSPB members are removable for "inefficiency, neglect of duty, or malfeasance in office."<sup>196</sup> However, because ALJs are impartial adjudicators, their double layer of protection is likely constitutional.

*1. History of the Removal Power*

Although the Constitution is silent with respect to the removal of officers, *Myers v. United States* held that "as [the President's] selection of administrative officers is essential to the execution of the laws by him, so must be his power of removing those for whom he can not continue to be responsible."<sup>197</sup> The Court later narrowed *Myers*' scope, permitting Congress to condition the President's removal of an Officer only "for inefficiency, neglect of duty or malfeasance."<sup>198</sup> The Court ruled that because the FTC exercised quasi-judicial and quasi-legislative power, it was not part of the executive branch.<sup>199</sup> As such, the agency's commissioners may act

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192 Interestingly, this argument represents a complete reversal from the Due Process argument, *see infra* Part IV, and alleges that ALJs are too far removed from executive control, as opposed to too beholden to their superiors.

193 U.S. CONST. art. II, § 3.

194 *See* Neomi Rao, *Removal: Necessary and Sufficient for Presidential Control*, 65 ALA. L. REV. 1205, 1225 (2014).

195 5 U.S.C. § 7521(a)–(b) (1995).

196 *Free Enter. Fund*, 561 U.S. at 486–87 (citation omitted); 5 U.S.C. § 1202(d) (1995).

197 272 U.S. 52, 117 (1926).

198 *Humphrey's Executor v. United States*, 295 U.S. 602, 620 (1935).

199 *Id.* at 628. *See also* Rao, *supra* note 194, at 1230.

“independently of executive control.”<sup>200</sup> In *Morrison v. Olson*, the Court held that an independent counsel was an inferior officer but ruled that Congress still could condition removal on for-cause reasons.<sup>201</sup>

Looking at these decisions together, a principal<sup>202</sup> or inferior<sup>203</sup> officer may be given for-cause protection from the President’s removal power, depending on their functions.

## 2. *Free Enterprise Fund v. PCAOB*

In *Free Enterprise*, the Court addressed whether the PCAOB could be shielded by two layers of for-cause removal.<sup>204</sup> It held that Sarbanes-Oxley imposed a “new type of restriction” on the President: “two levels of protection from removal for those who nonetheless exercise significant executive power. Congress cannot limit the President’s authority in this way.”<sup>205</sup>

However, *Free Enterprise*’s holding is unlikely to apply to ALJs. Unlike PCAOB members, “Executive branch adjudicators are not generally thought to have discretion in th[e] [policymaking or enforcement] sense, but rather like other judges to be applying the law to particular facts.”<sup>206</sup> The Court suggested as much, noting that the facts in *Free Enterprise* were unique.<sup>207</sup>

Additionally, the Court is likely to seek to limit *Free Enterprise*’s holding. Even in its decision, the Court distinguished ALJs and the PCAOB, noting that ALJs exercise adjudicative rather than enforcement or policymaking power; thus their double for-cause removal likely does not infringe unconstitutionally on the President’s removal power.<sup>208</sup>

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200 *Humphrey’s Executor*, 295 U.S. at 629. Some question whether *Humphrey’s Executor*’s reasoning is still applicable, since a majority of the Supreme Court has shifted from a formalist approach to a functionalist one, recognizing that “every federal entity must be accountable to one of the three branches.” Rao, *supra* note 194, at 1230–31.

201 *Morrison v. Olson*, 487 U.S. 654, 689 (1988) (“[T]he President’s power to remove an official cannot be made to turn on whether or not that official is classified as ‘purely executive.’”).

202 *See Humphrey’s Executor*, 295 U.S. at 629.

203 *See Morrison*, 487 U.S. at 689–91.

204 The Board was removable “‘for good cause shown,’ ‘in accordance with’ certain procedures.” *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 486 (2010) (quoting 15 U.S.C. § 7211(e)(6) (2002)).

205 *Id.* at 514.

206 Rao, *supra* note 194, at 1248.

207 *See Free Enter. Fund*, 561 U.S. at 503 (“Congress enacted an unusually high standard that must be met before Board members may be removed.”).

208 *Id.* at 507 n.10; *see also* Nelson, *supra* note 3, at 412 (“The majority itself thus recognized that the adjudicatory function makes the ALJs different from PCAOB members and properly beyond the reach of presidential removal power.”). *But see* *Freytag v. Comm’r*, 501 U.S. 868, 909 (1991) (Scalia, J., concurring in part and concurring in the judgment) (arguing that executive branch adjudicators exercise executive power).

Another reason to doubt that *Free Enterprise's* holding will be extended to ALJs is that the implications could be enormous.<sup>209</sup> Indeed, some question the strength of the distinctions the Court drew between the PCAOB and ALJs and suggest it was done to avoid such far-reaching implications.<sup>210</sup> It is not entirely clear that ALJs perform only an adjudicatory role.<sup>211</sup> The Court took a formalist approach toward the removal power, “begin[ning] with the premise that the structure of our constitutional democracy requires that the President oversee the work of his subordinates and ensure they are faithfully executing the laws,” regardless of the functions of those subordinates.<sup>212</sup> The dissent instead took a functionalist approach, recognizing the need for bureaucratic independence and stressing that the “second layer of removal protection ‘does not significantly interfere with the President’s executive Power,’ and ‘violates no separation-of-powers principle.’”<sup>213</sup> The dissent also recognized that the SEC’s “various means of control” over the PCAOB, even without removal power, were sufficient to place the PCAOB under presidential control.<sup>214</sup> Some academics believe *Free Enterprise's* holding could have a huge impact on agencies, depending on the Court’s willingness to extend it.<sup>215</sup>

Moreover, it would be unsound to extend *Free Enterprise* to ALJs, since adjudicators need the independence that for-cause removal provides.<sup>216</sup> It

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209 See *Free Enter. Fund*, 561 U.S. at 536 (Breyer, J., dissenting) (questioning whether ALJs who perform important administrative duties are implicated by the majority’s rule).

210 See, e.g., Barnett, *supra* note 119, at 815 (“The majority’s proposed distinctions are unsound as stated . . .”).

211 Cf. John L. Gedid, *ALJ Ethics: Conundrums, Dilemmas, and Paradoxes*, 11 WIDENER J. PUB. L. 33, 38 n.23 (2002) (noting that “in [NLRB’s] first fifty years of existence[,] the agency did not promulgate a single rule. Instead, it chose to make all decisions through adjudication.”).

212 Neomi Rao, Symposium, *A Modest Proposal: Abolishing Agency Independence in Free Enterprise Fund v. PCAOB*, 79 FORDHAM L. REV. 2541, 2553 (2011).

213 *Id.* at 2547 (quoting *Free Enter.*, 561 U.S. at 514 (Breyer, J., dissenting)).

214 *Id.* at 2555 (discussing instruments of control mentioned by Justice Breyer that place the PCAOB under presidential control).

215 See, e.g., *id.* at 2544–45 (“The Chief Justice’s opinion in time may be viewed like *Marbury v. Madison* . . . . [T]he Court’s proof—its emphasis on the importance of presidential control and accountability—calls into question the constitutionality of agency independence more generally.”); Nelson, *supra* note 3, at 417–18 (“[T]here is no reason to bring ALJs’ more limited and purely adjudicatory roles closer to presidential removal. Such a radical outcome, with a serious adverse impact on the fairness of the administrative adjudicatory system, is not required by *Free Enterprise's* treatment of PCAOB members.”); David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1193–94 (2016) (“The problem with these cases is that they seek to undo an institution that has been part of the furniture of administrative law since the passage of the APA. If taken seriously, they would undo most of the work of [ALJs], not just for the SEC, but also for other agencies as well.”).

216 See *Wiener v. United States*, 357 U.S. 349, 355–56 (1958) (noting that Congress “chose to establish a Commission to adjudicate . . . claims . . . free from the control or coercive

seems that “[a]t a minimum, within independent agencies, [*Free Enterprise*] preserves the second layer of removal protection only for dedicated adjudicators.”<sup>217</sup>

### III. THE IMPACT ON THE SEC AND THE ADMINISTRATIVE STATE IF THE SUPREME COURT WERE TO FIND AN APPOINTMENTS CLAUSE VIOLATION

If the Supreme Court were to rule that ALJs are inferior officers, and that they cannot be separated from the President’s control by two layers of for-cause removal protections, the implications could be far-reaching. With respect to the Take Care Clause, going forward, Congress and the Court would have to figure out how to reconcile between ensuring that ALJs are sufficiently impartial and independent of their agencies—thereby ensuring due process—while at the same time guaranteeing that they are sufficiently subject to presidential removal. It is not clear how this would be accomplished.

This section focuses on the implications of an Appointments Clause violation, since it appears more likely than a removal power issue. This Comment argues that the potential effect on SEC adjudications is likely to be limited to non-final cases. With respect to the administrative state as a whole, the impact is uncertain. It is unclear that litigants would be willing to challenge the appointments in agencies whose ALJs preside over less contentious hearings. Further, it is not apparent which other agencies have appointed their ALJs improperly.

#### A. *Impact of an Appointments Clause Violation on the SEC*

If the current SEC challenges—those that have not yet been subject to a final agency ruling—prevail and the Supreme Court were to rule that the only constitutional defect is the Appointments Clause violation, then the SEC would have to appoint its ALJs properly. However, this defect would not have a substantial effect on the substance of SEC proceedings, which is why it is curious that the SEC has not cured it. Several district court judges have even commented that the SEC has a simple remedy: have the

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influence, direct or indirect, of either the Executive or the Congress. . . . [A] fortiori must it be inferred that Congress did not wish to . . . [allow] removal by the President for no reason other than that he preferred to have on that Commission men of his own choosing.” (internal citation and quotation marks omitted); *see also* 5 U.S.C. § 554(d)(2) (2012) (requiring that a hearing officer not be “responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions”).

217 Kevin M. Stack, *Agency Independence After PCAOB*, 32 CARDOZO L. REV. 2391, 2419 (2011).

Commission appoint all of its ALJs.<sup>218</sup> Yet the SEC has resisted this “easy fix,”<sup>219</sup> presumably because having the Commissioners reappoint the ALJs may expose past decisions to scrutiny.<sup>220</sup>

Assuming the SEC was required to appoint its ALJs directly, the litigants then would have to endure the very proceedings they have been challenging, with little effect on the (likely adverse) outcome. Thus, the strongest legal challenge—the Appointments Clause claim—is unlikely to have a large practical impact. By contrast, the Due Process and Equal Protection claims, discussed below in Part IV, are weaker legal claims, but have led to reforms to the in-house proceedings, initiated by both the SEC and Congress. These claims are more likely to lessen the incongruity between the proceedings brought in-house and those brought in federal court.

Even if there is an Appointments Clause violation, the effect on prior SEC rulings would be cabined. Although a defect would invalidate a resulting order,<sup>221</sup> it would probably only impact cases that have raised direct challenges, namely those not yet subject to a final decision.<sup>222</sup> Since a final Commission order must be appealed within sixty days, the number of

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218 See *Hill v. SEC*, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015) (“Hill I”) (“[T]he ALJ’s appointment could easily be cured by having the SEC Commissioners issue an appointment.”).

219 See Letter at 1, *Duka v. SEC*, 103 F. Supp. 3d 382 (S.D.N.Y. 2015) (No. 15-cv-357), ECF No. 41 (noting that the judge in *Hill* “appears to have been opining on the ease of remedying the likely constitutional defect in the SEC ALJ’s appointment . . . . [The judge] apparently believes that the Commissioners could, with little difficulty and consistent with the Appointments Clause, appoint the ALJ as if he were an inferior officer”). However, the SEC did not address whether it was an easy fix or whether it would consider appointing the ALJs in this manner. Instead, the SEC has chosen to respond to the Due Process challenges and proposed new rules, which may have a greater impact on future SEC proceedings. See *infra* Part IV.B.

220 Alison Frankel, *Why the SEC Can’t Easily Solve Appointments Clause Problem with ALJs*, REUTERS (June 17, 2015), <http://blogs.reuters.com/alison-frankel/2015/06/17/why-the-sec-cant-easily-solve-appointments-clause-problem-with-aljs> (pointing out that reappointment of ALJs could be taken as an admission that prior appointments were not constitutionally sound).

221 See *Landry v. FDIC*, 204 F.3d 1125, 1132 (D.C. Cir. 2000) (“A defect in the appointment of an ‘examiner’ (precursor of today’s ALJ) was, if properly raised, ‘an irregularity which would invalidate a resulting order.’”) (quoting *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 38 (1952)).

222 See *United States v. Johnson*, 457 U.S. 537, 543 (1982) (citing favorably to the common law rule that “in both civil and criminal litigation, . . . a change in law will be given effect [only] while a case is on direct review”) (quoting *Linkletter v. Walker*, 381 U.S. 618 (1965) (internal quotation marks omitted)).

implicated cases is limited.<sup>223</sup> However, any litigant still before the SEC or a court of appeals may properly raise this challenge.<sup>224</sup>

The de facto officer doctrine jurisprudence<sup>225</sup> should preclude litigants from raising the Appointments Clause challenge on collateral appeal. The de facto officer doctrine is “an ancient but cloudy body of law designed to protect the acts of officials whose title to office has been challenged.”<sup>226</sup> It was developed in *Buckley v. Valeo*, where the Court held that even though the Federal Election Committee’s composition was invalid, that “should not affect the validity of the Commission’s administrative actions and determinations to this date . . . .”<sup>227</sup> Thus, the doctrine “guards against the ‘chaos’ that would otherwise result by protecting the validity of acts performed by a public officer whose appointment has been deemed invalid.”<sup>228</sup> However, its impact was narrowed in *Ryder v. United States*.<sup>229</sup>

In all likelihood, only litigants who raised the issue on direct appeal will be able to take advantage of a decision invalidating ALJs’ appointments. Collateral attack is unavailable, since the ALJ position is itself legally created by Congress, and all that must be cured is the appointment.<sup>230</sup>

The SEC will likely be unable to invoke the de facto officer doctrine to shield itself from direct challenges, however. The de facto officer doctrine “provided a defense when a party challenged government action based not on the invalidity of the law applied, but based on the invalidity of the public officer carrying out the action.”<sup>231</sup> In *Ryder*, the Supreme Court declined to apply that doctrine because the challenge was raised directly during the agency appeal.<sup>232</sup> The Court recognized the need to carve out an exception to the doctrine when one “makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case,” since to

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223 15 U.S.C. § 78y(a)(1) (2012).

224 *Ryder v. United States*, 515 U.S. 177, 177 (1995) (holding that because the Appointments Clause challenge was properly raised on direct appeal, the Court of Military Appeals erred in affirming the decision through the de facto officer doctrine).

225 See Deepak Gupta, *The Consumer Protection Bureau and the Constitution*, 65 ADMIN. L. REV. 945, 964–72 (2013) (explaining the de facto officer doctrine).

226 *Id.* at 947.

227 *Buckley v. Valeo*, 424 U.S. 1, 142 (1976) (per curiam).

228 Gupta, *supra* note 225, at 960.

229 *Ryder v. United States*, 515 U.S. 177 (1995). See Gupta, *supra* note 225, at 965 (observing that *Ryder* appears to narrow the de facto officer doctrine).

230 See *Ryder*, 515 U.S. at 182 (“[T]he title of a person acting with color of authority, even if he be not a good officer in point of law, cannot be collaterally attacked.”); *Ex parte Ward*, 173 U.S. 452, 454 (1899) (“[W]here a court has jurisdiction of an offense and of the accused, and the proceedings are otherwise regular, a conviction is lawful, although the judge holding the court may be only an officer de facto, and . . . the validity of the title of such judge . . . cannot be determined [collaterally].”).

231 Gupta, *supra* note 225, at 966.

232 *Ryder*, 515 U.S. at 187–88.



hold otherwise “would create a disincentive to raise Appointments Clause challenges with respect to questionable judicial appointments.”<sup>233</sup> That logic seems to apply to the present cases and might prevent the SEC from invoking the doctrine to avoid having to retry cases raising Appointments Clause challenges that have not reached final judgment.

However, it is possible that there could be a different result here and that the Court would not require any re-hearings. In *Ryder*, the issue was that the Court of Military Appeals<sup>234</sup> recently had ruled that the Court of Military Review judges were inferior officers,<sup>235</sup> but held that that ruling should be applied only prospectively.<sup>236</sup> The Supreme Court disagreed and opted not to invoke the remedial discretion doctrine, noting that “there is not the sort of grave disruption or inequity involved in awarding retrospective relief to this petitioner that would bring [the remedial discretion] doctrine into play,” since there were only seven to ten cases pending on direct review.<sup>237</sup> Here, there are likely more cases implicated, possibly leading the Court not to permit even current litigants to use the improper appointments to obtain new hearings. Additionally, the Court in *Ryder* noted that the higher military court had a limited scope of review.<sup>238</sup> However, here the SEC reviews ALJ decisions de novo, which might support application of the remedial discretion doctrine, since the plaintiffs did not clearly suffer harm.<sup>239</sup> Nonetheless, I argue that for direct challenges, the Court will require new hearings for those cases that raised the challenge on direct appeal, as it did in *Ryder*.<sup>240</sup> To hold otherwise would be to disincentivize Appointments Clause challenges, which was the exact concern that motivated the outcome in *Ryder*.

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<sup>233</sup> *Id.* at 182–83.

<sup>234</sup> *See id.* at 187 (noting that the Court of Military Appeals is “[t]he court of last resort in the military justice system”).

<sup>235</sup> *U.S. v. Carpenter*, 37 M.J. 291, 296 (1993).

<sup>236</sup> *Ryder*, 515 U.S. at 188.

<sup>237</sup> *Id.* at 185.

<sup>238</sup> *See id.* at 187 (noting that because the higher court had a limited scope of review, it was not harmless error).

<sup>239</sup> *See Landry v FDIC*, 204 F.3d 1125, 1140 (D.C. Cir. 2000) (Randolph, J., concurring) (finding that ALJs are inferior officers, but concurring in the decision to affirm the agency’s dismissal because the complainant “suffered no prejudicial error”).

<sup>240</sup> *See Kent Barnett, To the Victor Goes the Toil—Remedies for Regulated Parties in Separation-of-Powers Litigation*, 92 N.C. L. REV. 481, 529 (2014) (noting that the Court in *Ryder* required a new hearing for the petitioner because of the improper appointment); *see also* Gupta, *supra* note 225, at 969 (elaborating on the Court’s decision for the remedy that it provided in *Ryder*).

### B. *Recent Appointments Clause Violations*

Looking at how two recent unconstitutional appointments impacted the effected agencies provides further insight into the possible effects of an Appointments Clause violation, although neither appears to be much help to the SEC.

#### 1. *National Labor Relations Board*

On January 4, 2012, President Obama appointed three NLRB members as recess appointments. This action was challenged on the grounds that the Senate was not actually in recess and that President Obama simply had decided it was because senators were refusing to confirm his appointments.<sup>241</sup> In *NLRB v. Noel Canning*, the Court held that the appointments were unconstitutional.<sup>242</sup> Thus, the NLRB lacked the statutorily mandated quorum from January 4, 2012 until July 30, 2013, when the Senate confirmed the appointments. Consequently, the NLRB “issued roughly 700 reported and unreported decisions while sitting on quorum-less boards. Each of those decisions is arguably invalid.”<sup>243</sup> Some contended that the de facto officer doctrine could be used to avoid relitigating the 100 cases still pending in appeals courts.<sup>244</sup>

On remand, rather than relitigate the case, the NLRB stated that it considered the case de novo and agreed with the rationale set forth in the now-vacated Decision and Order. Accordingly, it affirmed the judge’s rulings, findings, and conclusions and adopted the judge’s recommended Order.<sup>245</sup> The D.C. Circuit affirmed.<sup>246</sup> The NLRB also ratified every agency action taken.<sup>247</sup> The NLRB likely will rubberstamp every decision, as it did in

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<sup>241</sup> Matthew C. Stephenson, *Can the President Appoint Principal Executive Officers Without a Senate Confirmation Vote?*, 22 YALE L.J. 940, 943 (2013).

<sup>242</sup> *NLRB v. Noel Canning*, 134 S. Ct. 2550, 2578 (2014).

<sup>243</sup> Bryan J. Leitch, *NLRB v. Noel Canning: The Separation-of-Powers Dialogue Continues*, 2014 CATO SUP. CT. REV. 221, 252–53 (2014).

<sup>244</sup> See, e.g., Ryan J. Levan, *Do We Have A Quorum?: Anticipating Agency Vacancies and the Prospect for Judicial Remedy*, 48 COLUM. J.L. & SOC. PROBS. 181, 205–06 (2015) (illustrating Justice Scalia’s remarks that the government could sufficiently depend on the de facto officer doctrine to validate decisions made by NLRB appointees).

<sup>245</sup> *Noel Canning v. NLRB*, 361 NLRB No. 129, 2014 WL 7189095, at \*1 (Dec. 16, 2014).

<sup>246</sup> *Noel Canning v. NLRB*, 823 F.3d 76, 81 (D.C. Cir. 2016).

<sup>247</sup> Press Release, NLRB Office of Pub. Affairs, NLRB Officials Ratify Agency Actions Taken During Period when Supreme Court Held Board Members Were Not Validly Appointed (Aug. 4, 2014), <https://www.nlr.gov/news-outreach/news-story/nlr-officials-ratify-agency-actions-taken-during-period-when-supreme-court> (declaring that “[t]he National Labor Relations Board unanimously ratified all administrative, personnel, and procurement matters taken by the Board”).

2010 when the Court also invalidated hundreds of its decisions for lack of a quorum.<sup>248</sup>

It is uncertain whether the SEC would be able to replicate the NLRB's tactic of rubber-stamping old rulings. Unlike the NLRB, it was a hearing officer, not a reviewing one, whose appointment was defective. As such, the SEC may have to hold a new hearing for any litigant whose case had not reached final judgment. However, it is also possible that the newly and properly appointed ALJs could review the record amassed by the defectively appointed ALJs and rubber-stamp the outcomes.

The SEC also may try and distinguish *Noel Canning*, since the Commission reviewed the hearing officer's actions de novo and therefore any error was harmless. This Comment does not believe the SEC would be successful.<sup>249</sup>

## 2. Consumer Financial Protection Bureau

Similar to the NLRB, the CFPB Director, Richard Cordray, was appointed improperly as a result of Senate Republicans' refusal to confirm anyone for the position due to political opposition to the Board's existence.<sup>250</sup> Cordray was not appointed until July 16, 2013.<sup>251</sup> *Noel Canning* would have been applicable to the CFPB. However, like the NLRB, Cordray, once confirmed, moved to ratify every action he took during that period.<sup>252</sup> Cordray's actions similarly are not replicable by the SEC, since the circumstances are distinguishable. The CFPB's authorizing statute stated: "The [Treasury] Secretary is authorized to perform the functions of the Bureau under this part until the Director of the Bureau is confirmed by the Senate in accordance with [12 U.S.C. § 5491]."<sup>253</sup> Accordingly, because "Dodd-Frank empowers the Acting Secretary of the Treasury to ratify certain actions of the Bureau when no director is in place[, t]his recourse along

248 See, e.g., J.S. Carambola, LLC, 355 N.L.R.B. 367, 367 (2010) ("The Board has reviewed the record in light of the exceptions and brief, and has adopted the hearing officer's findings and recommendations to the extent and for the reasons stated in the May 28, 2008 Decision.").

249 See *supra* note 240 and accompanying text.

250 Danielle Douglas, *Senate Confirms Cordray to Head Consumer Financial Protection Bureau*, WASH. POST (July 16, 2013), [https://www.washingtonpost.com/business/economy/senate-confirms-consumer-watchdog-nominee-richard-cordray/2013/07/16/965d82c2-ee2b-11e2-a1f9-ea873b7e0424\\_story.html](https://www.washingtonpost.com/business/economy/senate-confirms-consumer-watchdog-nominee-richard-cordray/2013/07/16/965d82c2-ee2b-11e2-a1f9-ea873b7e0424_story.html).

251 *Id.*

252 See Notice of Ratification, 78 Fed. Reg. 53734 (Aug. 30, 2013) ("I believe that the actions I took during the period I was serving as a recess appointee were legally authorized and entirely proper. To avoid any possible uncertainty, however, I hereby affirm and ratify any and all actions I took during that period.").

253 12 U.S.C. § 5586(a) (2010).

with the ‘de facto officer’ doctrine provides a sense of security for existing Bureau promulgations.”<sup>254</sup>

Although it is outside the scope of this Comment, it is also worth noting that the CFPB’s Director position has been challenged and was found to violate Article II.<sup>255</sup>

### C. Possible Repercussions for ALJs in Other Agencies

Since many other agencies also rely heavily on ALJs,<sup>256</sup> the implications of an Appointments Clause defect could extend beyond the SEC and send ripples through the administrative state. Its potential scope depends on both the nature of the functions and the extent of authority wielded by ALJs in other agencies, as well as the manner in which they were appointed.<sup>257</sup> As an initial matter, any ALJ in a non-department agency is, arguably, unconstitutionally appointed.<sup>258</sup> At least one agency was not willing to take any chances and preemptively had its department heads appoint its ALJs.<sup>259</sup> At least one agency appears to properly appoint its ALJs and therefore is not implicated by this issue.<sup>260</sup>

The agency that would be most impacted by an adverse Appointments Clause ruling is the Social Security Administration (“SSA”). The SSA employs 1400 ALJs, who have a caseload of 832,000.<sup>261</sup> Like SEC ALJs, SSA ALJs conduct hearings, manage factual information,<sup>262</sup> judge witness

<sup>254</sup> S. Austin King, *Mounting a Judicial Challenge to President Barack Obama’s Recess Appointment of Richard Cordray: The Constitutional Mandate of Standing*, 17 N.C. BANKING INST. 305, 330 (2013).

<sup>255</sup> PHH Corp. v. CFPB, 839 F.3d 1, 8 (D.C. Cir. 2016).

<sup>256</sup> For a list of agencies that utilize ALJs, see *Agencies Employing Administrative Law Judges*, Ass’n of Admin. Law Judges, <http://www.aalj.org/agencies-employing-administrative-law-judges> (last visited Dec. 29, 2016).

<sup>257</sup> See *Free Enter. Fund. V. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 556–92 apps. B & C (2010) (Breyer, J., dissenting) (noting that there are approximately 1284 ALJs, whose dual layer of for-cause removal could be constitutionally suspect, particularly if they have been defectively appointed).

<sup>258</sup> Barnett, *supra* note 119, at 810 n.77 (“For each ALJ appointment, one must know which entity is appointing and whether that entity is a department.”). For a list of agencies that “may not qualify as departments,” see *id.*

<sup>259</sup> Alison Frankel, *Unlike SEC, FTC Makes Quick Fix to Ward off ALJ Constitutional Challenges*, REUTERS (Sept. 16, 2015), <http://blogs.reuters.com/alison-frankel/2015/09/16/unlike-sec-ftc-makes-quick-fix-to-ward-off-alj-constitutional-challenges>.

<sup>260</sup> See Press Release, NLRB Office of Pub. Affairs, NLRB Appoints Four New Administrative Law Judges (Nov. 4 2013), <https://www.nlr.gov/news-outreach/news-story/nlr-appoints-four-new-administrative-law-judges> (“The National Labor Relations Board today announced the appointments of [various individuals] as [ALJs] . . .”).

<sup>261</sup> Lubbers, *supra* note 16, at 5. The SSA employs approximately 85% of all ALJs. *Id.*

<sup>262</sup> 20 C.F.R. § 404.944 (1995).

credibility,<sup>263</sup> issue subpoenas, and question witnesses.<sup>264</sup> They also issue written decisions and “give the findings of fact and the reasons for the decision.”<sup>265</sup> Indeed, there is a much stronger argument that SSA ALJs should be considered inferior officers,<sup>266</sup> since not every SSA ALJ decision is reviewed by the Appeals Council, and it becomes binding if the Council declines to hear it.<sup>267</sup> Thus, a party is not guaranteed review of an SSA ALJ’s decision.

It is unclear how the SSA appoints all its ALJs. Unlike the SEC, its regulations state that the Commissioner appoints ALJs in disability hearings, which would quash an Appointments Clause issue.<sup>268</sup> However, in a separate benefits section, an SSA regulation states that the “Deputy Commissioner for Disability Adjudication and Review, or his or her delegate,” appoints ALJs, which would expose the SSA to an Appointments Clause challenge.<sup>269</sup> That said, there may be practical reasons why these proceedings would not be challenged. Since a subject of an SSA hearing is seeking government benefits as opposed to defending against an enforcement action, he or she has less reason to challenge the ALJ’s constitutionality.<sup>270</sup> Nonetheless, it is possible that § 404.929 could be challenged.

Whether ALJs are inferior officers implicates other agencies as well. Several agencies’ ALJs, like the SSA’s, may issue final decisions in certain instances and thus likely would be inferior officers.<sup>271</sup> As such, the constitutionality of these ALJs is contingent on the nature of their appointments. Several of these agencies’ ALJs are not appointed by

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263 See *Molina v. Astrue*, 674 F.3d 1104, 1112 (9th Cir. 2012) (describing the analysis that ALJs must undertake when assessing the credibility of witnesses’ testimony).

264 20 C.F.R. § 404.950(d)–(e) (1995).

265 *Id.* § 404.943(c)(1).

266 See *Stack*, *supra* note 217, at 2408 n.101 (noting that SSA ALJs are inferior officers, “even under *Landry*’s restrictive reading of *Freitag*”).

267 20 C.F.R. § 404.955 (1995).

268 See *id.* § 405.301(b) (“The Commissioner will appoint an administrative law judge to conduct the hearing.”).

269 *Id.* § 404.929.

270 Indeed, the government is not even represented at SSA benefit proceedings. Richard J. Pierce, Jr., *What Should We Do About Social Security Disability Appeals?*, REGULATION, at 36 (Fall 2011), <https://object.cato.org/sites/cato.org/files/serials/files/regulation/2011/9/regv34n3-3.pdf>.

271 Timony, *supra* note 39, at 811 n.25 (listing agencies that allow ALJs to issue final agency determinations: Occupational Safety and Health Review Comm’n, Fed. Mine Safety and Health Review Comm’n, Civil Aeronautics Bd., and the Int’l Trade Comm’n). Other agencies whose ALJs may issue final determinations include: Small Bus. Admin., 13 C.F.R. § 134.409 (2016); NLRB, 29 C.F.R. § 101.12(b) (2015); U.S. Postal Serv., 39 C.F.R. § 966.11 (2015); and CFTC, 17 C.F.R. § 10.84(c) (2016).

Department Heads.<sup>272</sup> While this Comment is not aware of any such challenges, any agency whose ALJs are inferior officers could find itself in the same predicament as the SEC.

#### IV. EVEN IF ALJS ARE NOT INFERIOR OFFICERS, THE CURRENT LITIGATION HAS ALTERED SEC PRACTICES GOING FORWARD

The Due Process and Equal Protection challenges to the SEC's use of ALJs are unlikely to succeed. However, the publicity garnered by these complaints has pressured the SEC to funnel more enforcement actions to federal court and led it to propose new rules to modernize its in-house hearings. It has also driven Congress to propose the Due Process Restoration Act.

##### A. *Merits of Due Process and Equal Protection Claims Against the SEC*

This subsection briefly describes the Due Process and Equal Protection challenges, since they already have been thoroughly analyzed.<sup>273</sup> None of them are likely to succeed.

##### 1. *Due Process*

Because of the disparate amount of process afforded to litigants in federal court versus in SEC hearings, there have been significant complaints that litigants are entitled to more process than the SEC provides.<sup>274</sup> However, such claims are unlikely to succeed, given that the SEC's Rules of Practice "are, in most respects, similar to the Federal Rules of Civil Procedure . . . [and] are virtually identical to U.S. district court bench trials."<sup>275</sup>

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272 See, e.g., Small Bus. Admin., 13 C.F.R. § 134.218(a) (2016) ("The [Assistant Administrator for OHA] will assign all cases . . . to an [ALJ]."); Dep't of Labor, 29 C.F.R. § 2200.1(f) (2015) ("Judge means an [ALJ] appointed by the Chairman of the Commission."); U.S. Postal Serv., 39 C.F.R. § 953.10 (2015) ("The presiding officer at any hearing shall be an [ALJ] qualified in accordance with law (5 U.S.C. [§] 3105) and assigned by the Judicial Officer.").

273 For an in-depth analysis of these challenges, see Zaring, *supra* note 215.

274 See, e.g., *Chau v. SEC*, 72 F. Supp. 3d 417 (S.D.N.Y. 2014) (alleging that "the SEC's choice to pursue them administratively, as opposed to suing them in a United States District Court, [had] deprive[d] them of their rights to due process").

275 Daniel F. Solomon, *Summary of Administrative Law Judge Responsibilities*, 31 J. NAT'L ASSOC. ADMIN. L. JUDICIARY 475, 516 (2011); see also *Butz v. Economou*, 438 U.S. 478, 513 (1973) ("[F]ederal administrative law requires that agency adjudication contain many of the same safeguards as are available in the judicial process . . . [and] the role of the modern . . . [ALJ] is functionally comparable to that of a judge.") (internal quotation marks omitted); Zaring, *supra* note 215, at 1197 ("The Supreme Court has praised the

Depending on a case's complexity—which the SEC determines—an initial decision must be rendered within 120, 210, or 300 days, with at most four months to prepare for the hearing.<sup>276</sup> Additionally, the SEC's rules limit discovery<sup>277</sup> and allow pre-trial depositions only when a witness will be unable to testify at a hearing.<sup>278</sup> Moreover, it often can take over a year before a case makes its way into federal court,<sup>279</sup> at which point the court will defer on disputed facts,<sup>280</sup> making reversal difficult to attain. Although there is a looser evidentiary standard in SEC hearings, which permits the SEC to use hearsay evidence that otherwise would be excluded under the Federal Rules of Evidence,<sup>281</sup> hearsay is admissible because "[t]he rules of evidence are relaxed in an administrative proceeding."<sup>282</sup> The SEC also defers to its ALJs' findings and accepts "credibility finding[s], absent overwhelming evidence to the contrary."<sup>283</sup> Lastly, some argue that there is an inherent

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process offered by ALJs in the past, and agencies have been expressly permitted to combine the functions of enforcement and adjudication under one roof.").

276 17 C.F.R. § 201.360(a)(2) (1995); *see also* Ryan, *supra* note 19 (noting that there is not enough time to prepare for a hearing given that the SEC often spends years building cases). By contrast, Article III judges "follow no statutorily imposed deadline." Ryan Jones, Comment, *The Fight over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 524 (2015).

277 *See* Atkins & Bondi, *supra* note 30, at 411–12 (noting that the SEC is criticized for "failing to share critical incriminating—and most importantly, exculpatory—evidence that the SEC has gathered"). Judge Jed Rakoff, a noted critic of the SEC's use of ALJs, stated that the proceedings provide "much more limited discovery than federal actions, with no provision whatsoever for either depositions or interrogatories." Jed S. Rakoff, PLI Securities Regulation Institute Keynote Address 7 (Nov. 5, 2014). Judge Rakoff also has criticized the SEC for exerting undue pressure to force settlements and using consent judgments and has wondered, "from where does the constitutional warrant for such unchecked and unbalanced administrative power derive?" SEC v. Citigroup Glob. Mkts., Inc., 34 F. Supp. 3d 379, 380 n.8 (S.D.N.Y. 2014).

278 17 C.F.R. § 201.233(b) (1995).

279 Ryan, *supra* note 19.

280 *See* 15 U.S.C. § 78y(4) (2012) ("The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive."); *see also* Penasquitos Vill., Inc. v. NLRB, 565 F.2d 1074, 1078 (9th Cir. 1977) ("[A] reviewing court will review more critically the Board's findings of fact if they are contrary to the administrative law judge's factual conclusions.").

281 *See, e.g.*, Gonnella, Exchange Act Release No. 1579, at \*2 (July 2, 2014) ("There is no *per se* bar to the admission of hearsay evidence in the Commission's administrative proceedings. . . . [H]earsay evidence that is relevant is admissible in administrative proceedings.").

282 *Oversight of the SEC's Division of Enforcement: Hearing on H.R. 114-9 Before the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 114th Cong. 26 (2015) (presenting the statement of Andrew J. Ceresney, Director, SEC Division of Enforcement). The Supreme Court also has noted that "differences in the origin and function of administrative agencies preclude wholesale transplantation of the rules of procedure, trial, and review which have evolved from the history and experience of courts." Mathews v. Eldridge, 424 U.S. 319, 348 (1976) (internal quotation marks omitted).

283 Ironridge Global IV, Ltd. v. SEC, 146 F. Supp. 3d 1294, 1298 (2015).

peculiarity in having the SEC Commissioners—the very people who authorize the Enforcement Division to initiate an action—review whether the Enforcement Division has failed to prove its case.<sup>284</sup>

However, some argue that these concerns are overblown.<sup>285</sup> Litigants in SEC proceedings are given more process than is constitutionally required in an agency hearing.<sup>286</sup> As such, this argument is unlikely to advance far in federal court.

Another challenge leveled against the SEC is the lack of a jury, which otherwise would be available in federal court.<sup>287</sup> This argument is similarly unconvincing, since Congress is permitted to assign cases to administrative proceedings that otherwise would be brought in federal court.<sup>288</sup>

Academics also question whether ALJs are sufficiently impartial.<sup>289</sup> Even though ALJs are removable only for-cause, their “effective life tenure . . . loses some of its sheen because of the ambiguity of the good cause standard . . . .”<sup>290</sup> Indeed, in a recent SEC hearing in which the ALJ’s independence was questioned, the SEC invited the ALJ to submit an affidavit stating whether he felt undue pressure from the SEC to rule in its favor

<sup>284</sup> Walfish, *supra* note 19; *cf.* Wong Yang Sung v. McGrath, 339 U.S. 33, 41 (1950) (explaining that one of the purposes of the APA was “to curtail and change the practice of embodying in one person or agency the duties of prosecutor and judge”), *overruled on other grounds by* Ardestani v. INS, 502 U.S. 129, 133 (1995).

<sup>285</sup> *See Oversight of the SEC’s Division of Enforcement*, *supra* note 282, at 26 (providing Ceresney’s statement that there is “more extensive discovery. . . . [for] documents and items that are in [its] file” because the SEC “turn[s] over [its] whole file, typically within 7 days” as required by SEC rules); *see also* Zaring, *supra* note 215, at 1198 (noting that “ALJs have been held up as examples of due process” by the Supreme Court); *id.* (citing Fed. Mar. Comm’n v. South Carolina State Ports Auth., 535 U.S. 743, 759 (2002)) (internal quotation marks omitted) (“[T]he similarities between adjudication before ALJs and before federal district court judges are overwhelming.”).

<sup>286</sup> *See* Zaring, *supra* note 215, at 1197–99 (arguing that parties appearing before SEC ALJs are not constitutionally entitled to more process than they receive).

<sup>287</sup> Complaint for Declaratory and Injunctive Relief, *supra* note 50, at 17; *see also* U.S. CONST. amend. VII (“In Suits at common law . . . the right of trial by jury shall be preserved . . .”).

<sup>288</sup> Zaring, *supra* note 215, at 1205.

<sup>289</sup> *See* Barnett, *supra* note 119, at 827 (questioning whether “the current administrative system is in excellent health,” but noting that “[d]espite concerns over ALJ impartiality . . . the Supreme Court may not find a due process violation, given its wariness of upsetting long-standing administrative practices”); Harold H. Bruff, *Specialized Courts in Administrative Law*, 43 ADMIN. L. REV. 329, 352 (1991) (“[T]hose who work within an agency are subject to a multitude of open or subtle socializing pressures.”); L. Harold Levinson, *The Status of the Administrative Judge*, 38 AM. J. COMP. L. 523, 537 (1990) (“Large numbers of hearing officers . . . are non-tenured. They must, nevertheless, render independent and impartial decisions.”). *But see* Harold J. Krent & Lindsay DuVall, *Accommodating ALJ Decision Making Independence with Institutional Interests of the Administrative Judiciary*, 25 J. NAT’L ASS’N ADMIN. L. JUDGES 1, 4 n.11 (2005) (“[T]he APA protections insulate ALJs far more than due process dictates.”).

<sup>290</sup> Barnett, *supra* note 119, at 807.



and—in a move that certainly raised more than a few eyebrows—the ALJ refused.<sup>291</sup> As of May 6, 2015, that same ALJ—who has worked for the SEC since 2011—had never ruled against the SEC.<sup>292</sup> Additionally, a former SEC ALJ, Lillian McEwen, stated that she felt the procedures unfairly favored the SEC, that the Chief ALJ had “questioned [her] loyalty,” and that she was “expected to work under an assumption that the burden was on the people who were accused to show that they didn’t do what the agency said they did.”<sup>293</sup> The SEC’s Office of Inspector General investigated these allegations<sup>294</sup> and cleared the SEC of any improper bias toward its ALJs.<sup>295</sup> Possibly undermining the claim that ALJs are insufficiently independent, one ALJ recently granted a subpoena request for “[a]ll documents and communications that support, or reflect or are related to the allegations made by Lillian McEwen,”<sup>296</sup> thereby permitting an inquiry into the merits of the impartiality accusations.

Others have criticized the disparity between the SEC’s success in federal court and in administrative proceedings,<sup>297</sup> which the SEC has acknowledged.<sup>298</sup> However, Supreme Court precedent suggests that ALJs are not too partial.<sup>299</sup> Accordingly, this argument is unlikely to succeed absent proof that improper pressure is exerted on ALJs.

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291 Complaint for Declaratory and Injunctive Relief at 9–10, *Timbervest, LLC v. SEC*, No. 1:15-cv-02106-LMM, 2015 WL 7597428 (N.D. Ga. June 12, 2015).

292 Eaglesham, *supra* note 19.

293 *Id.*

294 Interim Report of Investigation, SEC Office of Inspector General (Aug. 7, 2015), <https://www.sec.gov/oig/reportspubs/oig-sec-interim-report-investigation-admin-law-judges.pdf>.

295 Suzanne Barlyn, *Watchdog Clears U.S. SEC’s In-House Judges of Bias Allegations*, REUTERS (Feb. 16, 2016, 4:57 PM), <http://www.reuters.com/article/us-sec-court-bias-idUSKCN0VP2OL>.

296 Hill, Exchange Act Release No. 2706, at \*2 (May 21, 2015), <https://www.sec.gov/alj/aljorders/2015/ap-2706.pdf>.

297 Rakoff, *supra* note 277, at 7.

298 *See Oversight of the SEC’s Division of Enforcement*, *supra* note 282, at 26–27 (statement of Ceresney) (confirming that in the prior year, the SEC won 100 percent of its cases in agency hearings, but won only 11 of 18 cases in federal court). This disparity did not go unnoticed by Congress. *See id.* at 27 (Congressman Duffy testifying, “Do you think there could be any correlation when you actually hire the judges and you set the rules that you win all the cases? . . . And you might say . . . I want to bring more cases in front of the judges that I hire and abide by the rules that I set as opposed to letting these cases go into Federal court. And low and behold, wow, I win them all.”).

299 *See Withrow v. Larkin*, 421 U.S. 35, 52 (1975) (“[C]ase law, both federal and state, generally rejects the idea that the combination of judging and investigating functions is a denial of due process.”) (alterations omitted); Zaring, *supra* note 215, at 1199–1200 (noting that people have long complained that the SEC operates as prosecutor and judge, but that claim “has never gone very far in the courts”); Barnett, *supra* note 119, at 820–21 (“Although certain of these decisions strongly suggest that ALJs are sufficiently

## 2. *Equal Protection and Choice of Venue Claims*

Those raising Equal Protection claims argue that the SEC unfairly targeted them by forcing them to undergo an in-house proceeding. They claim that the SEC acted arbitrarily with respect to where it chose to bring actions, depriving in-house litigants of the benefits of the Federal Rules of Civil Procedure and Federal Rules of Evidence.<sup>300</sup> However, Congress has explicitly allowed the SEC to select its preferred forum.<sup>301</sup> Nonetheless, claimants note the “lack of *any* congressional principal guiding the Commission’s selection of a forum.”<sup>302</sup> In response, the SEC published guidelines for how it decides which forum to select,<sup>303</sup> which is entitled to some degree of deference<sup>304</sup> even though the factors the SEC gave are vague.<sup>305</sup>

Moreover, courts generally defer to an agency’s decision to bring claims against individuals.<sup>306</sup> The only successful SEC Equal Protection claim this Comment is aware of contained particularly egregious facts, wherein the challenger was the only one out of twenty-nine co-defendants subjected to an in-house hearing.<sup>307</sup> That court denied the SEC’s motion to dismiss

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impartial in fact and appearance, scholars have not considered the impact of the decisions’ limitations, especially after . . . *Free Enterprise Fund*.”).

<sup>300</sup> See, e.g., Complaint for Declaratory and Injunctive Relief, *supra* note 50, at 23–25.

<sup>301</sup> H.R. REP. NO. 111-687, at 78 (2010). Dodd-Frank renders “the SEC’s authority in administrative penalty proceedings coextensive with its authority to seek penalties in Federal court.” *Id.*

<sup>302</sup> Complaint for Declaratory and Injunctive Relief, *supra* note 50, at 28.

<sup>303</sup> *Division of Enforcement Approach to Forum Selection in Contested Actions*, SEC ENF’T DIV., <http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf> (last visited Dec. 29, 2016) (listing the non-exhaustive factors it considers: the availability of the desired claims, legal theories, and forms of relief in each forum; the cost-, resource-, and time-effectiveness of litigation in each forum; fair, consistent, and effective resolution of securities law issues).

<sup>304</sup> See *United States v. Mead Corp.*, 533 U.S. 218, 226–27 (2001) (holding “that administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority,” even absent administrative formality); see also Zaring, *supra* note 215, at 1190 (“[T]he agency’s policy of initiating more administrative proceedings is a reasonable interpretation of the amendments to Dodd-Frank authorizing it to do so . . . .”)

<sup>305</sup> See Complaint for Declaratory and Injunctive Relief, *supra* note 50, at 29 (claiming that the SEC’s guidelines “offer little clarity as to how the SEC goes about selecting the forum”).

<sup>306</sup> *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 248 (1980); cf. *United States v. Armstrong*, 517 U.S. 456, 464 (1996) (noting the discretion afforded to federal prosecutors when they are deciding whether to bring criminal charges).

<sup>307</sup> See *Gupta v. SEC*, 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011) (asserting that “the [SEC]—having previously filed all of its Galleon-related insider trading actions in this federal

because “there is already a well-developed public record of Gupta being treated substantially disparately from 28 essentially identical defendants, with not even a hint from the SEC, even in their instant papers, as to why this should be so.”<sup>308</sup> However, the facts in *Gupta v. SEC* are unique and do not seem to pave a path for other litigants to successfully raise equal protection claims.<sup>309</sup> It also is unclear whether the claim ultimately would have succeeded, since the SEC dropped the in-house charges and re-filed them in federal court.<sup>310</sup> Therefore, those raising Equal Protection claims are unlikely to prevail.

## B. Current Efforts to Respond to the Due Process Concerns

### 1. Effects on Current SEC Litigation

Despite contrary rhetoric, the SEC seems to be altering its enforcement strategy in response to the complaints and scaling back its use of ALJs in contested cases. In the first and second quarters of fiscal year 2015, the SEC brought close to 40% and 50% of its contested cases in-house, respectively, which dropped to just over 20% in the third quarter and again to just 11% in the fourth quarter.<sup>311</sup> The 11% fourth quarter number represents a substantial decrease from the 40% brought in the previous year's fourth quarter.<sup>312</sup> According to the Wall Street Journal, sources familiar with the SEC claim that SEC Director Andrew Ceresney told senior staff to file contested cases alleging insider trading or accounting fraud in federal court absent good reason to utilize SEC ALJs.<sup>313</sup> Indeed, since *Hill*, the SEC has brought every suspected insider trading case in federal court.<sup>314</sup> Since May

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district—decided it preferred its home turf” and referring to the SEC's actions as a “seeming exercise in forum-shopping”).

<sup>308</sup> *Id.* at 514.

<sup>309</sup> See *Jarkesy v. SEC*, 803 F.3d 9, 23 (D.C. Cir. 2015) (noting that *Gupta's* “broad definition misconceives how the Supreme Court and our court have understood the term ‘wholly collateral’ in the *Thunder Basin* line of cases”); *Chau v. SEC*, 72 F. Supp. 3d 417, 431 (S.D.N.Y. 2014) (noting that *Gupta*, even if correctly decided, was factually distinguishable).

<sup>310</sup> *SEC v. Gupta*, No. 11 Civ. 7566(JSR), 2012 WL 6767789 (S.D.N.Y. Dec. 26, 2012).

<sup>311</sup> Jean Eaglesham, *SEC Trims Use of In-House Judges: Regulator Sends Fewer Cases to Its Tribunal, A Practice That Brought It Legal Challenges*, WALL ST. J. (Oct. 11, 2015, 9:00 PM), <http://www.wsj.com/articles/sec-trims-use-of-in-house-judges-1444611604>.

<sup>312</sup> *Id.*

<sup>313</sup> *Id.*

<sup>314</sup> *Id.*; see, e.g., Press Release, SEC, SEC Charges Pennsylvania Attorney with Insider Trading in Advance of Merger Announcement (July 16, 2015), <https://www.sec.gov/news/pressrelease/2015-149.html>; Press Release, SEC, SEC Charges Company Executive with Insider Trading (Feb. 5, 2016), <https://www.sec.gov/news/pressrelease/2016-24.html>; Press Release, SEC, Childhood Friends Charged with Insider Trading in Pharmaceutical Stocks (June 3, 2016), <https://www.sec.gov/news/pressrelease/2016-108.html>; Press

2015, the SEC's success rate also is down, as four of the last twelve defendants in contested cases have been cleared by ALJs, lowering the SEC's success rate to 72%.<sup>315</sup>

## 2. Prospective SEC and Congressional Responses

Although the SEC claims it is not in response to the ongoing challenges, it recently proposed and enacted new rules "to modernize our rules of practice for administrative proceedings, including provisions for additional time and prescribed discovery for the parties."<sup>316</sup> These rules were recently ratified and became effective September 27, 2016.<sup>317</sup> They appear to be responses to both the negative publicity stemming from the Due Process challenges as well as the risk of losing as a result of the Appointments Clause challenges.

Some of the SEC's rule changes are fairly defendant-friendly.<sup>318</sup> The SEC will extend the time frame for ALJs to issue decisions, increasing flexibility for when the hearing must be held, and making it easier to obtain a deadline extension.<sup>319</sup> In the most complex ten-month cases, the SEC will permit a respondent to take three depositions, or five if there is more than one respondent, as well as to request from the hearing officer for leave to take two additional depositions.<sup>320</sup> The SEC also enacted a rule to toll the Rule 360 time deadlines when the Commission is considering settlement offers.<sup>321</sup>

However, there also are several noticeably agency-friendly changes. A respondent must affirmatively state in its answer any theory for avoiding liability, not just affirmative defenses.<sup>322</sup> Respondents also must state whether they intend to raise as a defense the reliance on professional advice.<sup>323</sup> The SEC now permits an ALJ or the Commission to quash a subpoena not only if it would be "unreasonable, oppressive, or unduly

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Release, Securities and Exchange Commission, SEC Charges Hedge Fund Manager Leon Cooperman with Insider Trading (Sept. 21, 2016), <https://www.sec.gov/news/pressrelease/2016-189.html> (last visited Oct. 30, 2016).

<sup>315</sup> Eaglesham, *supra* note 311.

<sup>316</sup> Press Release, SEC, *supra* note 12.

<sup>317</sup> See Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50212, (July 29, 2016).

<sup>318</sup> Rather than recite each of the recently proposed rules, I will briefly set forth a few of the ones more pertinent to this Comment.

<sup>319</sup> See Amendments to the Commission's Rules of Practice, 81 Fed. Reg. at 50214 (codified at 17 C.F.R. § 201.360 (2016)).

<sup>320</sup> *Id.* at 50216 (codified at 17 C.F.R. § 201.233 (2016)).

<sup>321</sup> *Id.* at 50219 (codified at 17 C.F.R. § 201.161 (2016)).

<sup>322</sup> *Id.* at 50219–20 (codified at 17 C.F.R. § 201.220 (2016)) (enabling the SEC to learn a defendant's theory of the case prior to the hearing).

<sup>323</sup> *Id.* at 50220 (codified at 17 C.F.R. § 201.220 (2016)).

burdensome” but also if it would “unduly delay” the hearing.<sup>324</sup> The SEC also proposed making it possible to serve an order on a person in a foreign country by any “method authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents.”<sup>325</sup>

In addition to the SEC’s rules, Congress also has sought to change SEC in-house proceedings. Congress proposed a bill that not only would allow for any respondent subject to a cease and desist order to remove the case to federal court, but also would raise the required standard of proof in SEC proceedings from a preponderance of the evidence to clear and convincing evidence.<sup>326</sup> If passed, the bill would eviscerate the choice of venue power that Dodd-Frank conferred on the SEC.

However, regardless of what efforts the SEC and Congress undertake to better align SEC proceedings with those in federal court, they will fall short of what is available to litigants in federal court.<sup>327</sup> Further, experienced lawyers will continue looking for ways to challenge the SEC’s enforcement tactics and its use of ALJs in contested cases.

### CONCLUSION

The future of ALJs, both within the SEC and throughout the administrative state, is at a crossroads. The impact of a highly publicized finding that ALJs are inferior officers could send ripples throughout the administrative system. It could leave uncertain the legitimacy of ALJ decisions in other agencies and temporarily destabilize the administrative state while agencies scrambled to respond. However, the actual implications on past SEC in-house hearings would be cabined.

With respect to the current SEC challenges, because the SEC already has proposed new rules to modernize its in-house proceedings—regardless of the outcome of these Appointments Clause cases—the challengers already may have achieved a substantive victory. As a legal matter, the Due Process challenges are not particularly compelling, yet they may result in changes to the SEC’s practices that a successful Appointments Clause claim could not bring about. Although some say the changes are still inadequate in

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<sup>324</sup> *Id.* at 50218 (codified at 17 C.F.R. § 232(e)(2) (2016)).

<sup>325</sup> *Id.* at 50218–19 (codified at 17 C.F.R. § 141(a)(2)(iv) (2016)).

<sup>326</sup> *See* Due Process Restoration Act of 2015, H.R. 3798, 114th Cong. § 2(a) (2015).

<sup>327</sup> If Congress tried to give ALJs unfettered power in insider trading claims, or make SEC proceedings nearly identical to those in federal courts, it may raise other constitutional issues. *Cf.* *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 76 (1982) (holding that Article III forbids Congress from granting Article I bankruptcy judges the power “to exercise jurisdiction over all matters related to those arising under the bankruptcy laws”).

comparison to what is available in federal court,<sup>328</sup> these litigants, by pressuring the SEC to reform its proceedings, may unravel a significant aspect of Dodd-Frank. Win or lose in court, if the Due Process Restoration Act of 2015 is enacted, these SEC respondents will get what they wanted all along: their day in federal court.

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<sup>328</sup> See Eaglesham, *supra* note 19 (reporting that defense attorneys believe the proposals do not go far enough).